

United States

Circuit Court of Appeals

For the Ninth Circuit.

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*Vol*  
*2375*

MINNIE L. WHITTHORNE and EVA WHIT-  
THORNE, Executrices of the Estate of W. R.  
Whitthorne, deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent,

and

SHERWOOD SWAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

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Transcript of the Record

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Upon Petitions to Review Decisions of the  
United States Board of Tax Appeals

**FILED**

JUL 18 1942

**PAUL W. O'BRIEN,**  
**CLERK**



United States

Circuit Court of Appeals

For the Ninth Circuit.

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United States Board of Tax Appeals





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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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For Taxpayer:

ROBERT W. MACDONALD.

For Commissioner:

T. W. MATHER,

R. C. WHITLEY.

Docket No. 101189

W. R. WHITTHORNE (Amended title, order of 10/21/40), Estate of W. R. Whitthorne, Deceased, Minnie L. Whitthorne and Eva Whitthorne, Executrices,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

---

DOCKET ENTRIES

1940

Jan. 16—Petition received and filed. Taxpayer notified. Fee paid.

Jan. 16—Copy of petition served on General Counsel.

Jan. 19—Amendment to petition filed by taxpayer. 1/19/40 copy served.

Feb. 15—Answer filed by General Counsel.

Feb. 15—Request for Circuit hearing in San Francisco filed by General Counsel.



1940

- Feb. 24—Notice issued placing proceeding on San Francisco calendar. Service of answer and request thereon.
- Aug. 13—Hearing set Oct. 7, 1940, San Francisco.
- Oct. 7—Order, withdrawal of Hillyer Brown and Chas. L. Barnard as counsel for taxpayer, and Robert W. Macdonald be substituted entered.
- Oct. 21—Hearing had before Mr. Sternhagen on merits. Hillyer Brown and Chas. L. Barnard allowed to withdraw. Robert W. Macdonald made counsel. Motion to substitute parties granted. Appearance of Robert W. Macdonald. Motion to amend petition. Second amendment to petition filed. Petitioner's brief due November 30, 1940. General Counsel December 31, 1940. Petitioner's reply January 20, 1941.
- Oct. 21—Order amending title to The Estate of W. R. Whitthorne, Deceased, Minnie L. Whitthorne and Eva Whitthorne, Executrices, entered.
- Oct. 31—Answer to second amendment to petition filed by General Counsel. November 1, 1940, copy served.
- Nov. 12—Transcript of hearing Oct. 21, 1940, filed.
- Nov. 29—Motion for extension to Dec. 12, 1940, to file brief filed by taxpayer. 11/29/40 granted.



1940

Dec. 11—Brief filed by taxpayer. 12/11/40 copy served on General Counsel. [1\*]

1941

Jan. 11—Motion for extension of time to 1/22/41 to file reply brief filed by General Counsel. 1/13/41 granted.

Jan. 22—Motion for extension to Feb. 21, 1941, to file reply brief filed by General Counsel. 1/23/41 granted.

Feb. 20—Reply brief filed by General Counsel.

Mar. 3—Motion for extension to Mar. 25, 1941, to file reply brief filed by taxpayer. (1) Copies received 3/12/41. 3/5/41 granted.

Mar. 26—Motion for extension to April 4, 1941, to file reply brief filed by taxpayer. 3/26/41 granted.

Mar. 31—Reply brief filed by taxpayer. (Index to original brief also received.) 3/31/41 copy served on General Counsel.

Aug. 13—Findings of fact and opinion rendered, Sternhagen, #10. Decision will be entered under Rule 50. 8/14/41 copy served.

Sept. 9—Computation of deficiency filed by General Counsel.

Sept. 11—Hearing set Oct. 1, 1941, on settlement.

Oct. 1—Hearing had before Mr. Arundell on Rule 50. Not contested. Referred to Sternhagen for decision.

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[\*Page numbering appearing at top of page of original Reporter's Transcript.]

1941

Oct. 2—Decision entered. Sternhagen, Division 10.

Dec. 26—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, filed by taxpayer, with affidavit of mailing.

1942

Feb. 6—Certified copy of order and affidavit from the U. S. Circuit Court of Appeals, 9th Circuit, extending the time 30 days from Feb. 4, 1942, within which to file the certified record filed.

Feb. 12—Stipulation to omit certain portion of the reporter's transcript filed.

Feb. 27—Praecipe for record filed by taxpayer, with proof of service thereon.

Mar. 4—Certified copy of order from the 9th Circuit re consolidation and preparing single record filed.

Mar. 4—Certified copy of order and affidavit from the 9th Circuit extending the time 15 additional days from March 6, 1942, within which to file the certified record filed. [2]

Appearances:

For Taxpayer:

ROBERT W. MACDONALD.

For Commissioner:

T. W. MATHER,

R. C. WHITLEY.

Docket No. 101190

SHERWOOD SWAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

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Feb. 16—Request for Circuit hearing in San Francisco filed by General Counsel.

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Aug. 13—Hearing set Oct. 7, 1940, San Francisco.

1940

- Oct. 7—Order, withdrawal of Hillyer Brown and Chas. L. Barnard as counsel for petitioner, and Robert W. Macdonald be substituted entered.
- Oct. 21—Hearing had before Mr. Sternhagen on merits. Hillyer Brown and Chas. L. Barnard allowed to withdraw. Robert W. Macdonald substituted as counsel. (Petitioner's motion to substitute parties in docket #101189) Petitioner's motion to amend. Second amendment filed at hearing. Petitioner's brief due 11/30/40. General Counsel's brief due 12/31/40. Petitioner's reply brief due 1/20/41.
- Oct. 31—Answer to second amendment to petition filed by General Counsel.
- Nov. 12—Transcript of hearing, Oct. 21, 1940, filed.
- Nov. 29—Motion for extension to Dec. 12, 1940, to file brief filed by taxpayer. 11/29/40 granted.
- Dec. 11—Brief filed by taxpayer. 12/11/40 copy served on General Counsel.

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- Jan. 11—Motion for extension of time to Jan. 22, 1941, to file reply brief filed by General Counsel. 1/13/41 granted.
- Jan. 22—Motion for extension to Feb. 21, 1941, to file reply brief filed by General Counsel. 1/23/41 granted.
- Feb. 20—Reply brief filed by General Counsel. [3]

1941

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- Mar. 26—Motion for extension to April 4, 1941, to file reply brief filed by taxpayer. 3/26/41 granted.
- Mar. 31—Reply brief filed by taxpayer. (Index to original briefs also received.) 3/31/41 copy served on General Counsel.
- Aug. 13—Findings of fact and opinion rendered. Sternhagen, #10. Decision will be entered under Rule 50. 8/14/41 copy served.
- Sept. 9—Computation of deficiency filed by General Counsel.
- Sept. 11—Hearing set Oct. 1, 1941, on settlement.
- Oct. 1—Hearing had before Mr. Arundell on Rule 50. Not contested. Referred to Sternhagen for decision.
- Oct. 2—Decision entered. Sternhagen, Division 10.
- Dec. 26—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, filed by taxpayer, with affidavit of mailing.

1942

- Feb. 6—Certified copy of order and affidavit from the U. S. Circuit Court of Appeals, 9th Circuit, extending the time 30 days from Feb. 4, 1942, within which to file the certified record filed.
- Feb. 12—Stipulation to omit certain portions of the reporter's transcript filed.

1942

Feb. 27—Praecipe for record filed by taxpayer, with proof of service thereon.

Mar. 4—Certified copy of order from the 9th Circuit re consolidation and preparing single record filed.

Mar. 4—Certified copy of order from the 9th Circuit extending the time fifteen additional days from March 6, 1942, within which to file the certified record filed. [4]

---

United States Board of Tax Appeals

Docket No. 101189

W. R. WHITTHORNE,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

### PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D/LB), dated October 20, 1939, and as a basis of his proceeding alleges as follows:

#### I.

Petitioner is an individual with residence in the City of Oakland, County of Alameda, State of California.



II.

That a notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to Petitioner on October 20, 1939.

III.

The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$9,902.53 and penalty in the amount of \$495.12. [5]

IV.

The determination of the tax set forth in the said notice of deficiency is based upon the following errors and each thereof:

(a) The Commissioner erred in finding that Petitioner received any benefit whatsoever in the calendar year 1936 by the cancellation during said calendar year of the indebtedness owing by him to Bank of America National Trust and Savings Association and Central National Bank of Oakland in the aggregate sum of \$80,009.13 and the respective sums of \$24,968.47 and \$55,040.66, since the benefit arose from a transaction which took place in the calendar year 1930.

(b) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, the Commissioner nevertheless erred in holding and determining that the benefit to Petitioner from said cancellation of indebtedness, or any part thereof, constituted taxable income to Petitioner as, under the circumstances hereinafter alleged, said cancellation of indebtedness is not in-

come within the meaning of the Revenue Act of 1936 or the Sixteenth Amendment to the Constitution.

(c) The Commissioner erred in finding that, during the calendar year 1936, Petitioner realized a reportable [6] capital gain on the sale of a one-half interest in 1,000 shares of Sherwood Swan and Company, Ltd. in the amount of \$19,895.25. However, Petitioner sold during said calendar year 1936, 6,250 Class A shares of Sherwood Swan and Company, Ltd. for an aggregate selling price of \$43,750. The cost allocable to said 6,250 Class A shares was \$14,771.17 and Taxpayer realized a gain of \$28,978.83 on said sale of Class A shares, and a reportable gain of \$8,693.65.

(d) The Commissioner erred in assessing against Petitioner a 5% penalty under Section 291 of the Revenue Act of 1936 on account of the alleged delinquent filing by Petitioner of his return for said calendar year. [7]

## V.

The facts upon which the Petitioner relies as the basis of this proceeding are as follows:

In support of assignment of error (a) above:

1. In March 1930, Petitioner's assets consisted solely of:

(i) An account receivable due from Sherwood Swan and Company, Ltd. in the amount of \$5,567.34;

(ii) 500 Shares of Sherwood Swan and Company, Ltd.;



(iii) 6,000 shares of Hale Bros. Stores, Inc.;

(iv) 1,725 shares of Wasserman-Gattman Co.; and

(v) 2,000 shares of Swan's (a corporation); and

the liabilities of Petitioner consisted of:

((i)) Joint note of Petitioner and Sherwood Swan to Harrison S. Robinson in the principal amount of \$35,000, secured by pledge of 1,000 shares of Sherwood Swan and Company, Ltd. (held by Petitioner and Sherwood Swan, jointly);

((ii)) Joint unsecured note of Petitioner and Sherwood Swan to Bank of America National Trust and Savings Association in the principal amount of \$100,000;

((iii)) Joint notes of Petitioner and Sherwood Swan to Central National Bank of Oakland in the aggregate principal amount of \$250,000, secured by 6,000 shares of Hale Bros. Stores, Inc., held by Petitioner; and

((iv)) Joint purchase money note of Petitioner and Sherwood Swan to David S. Wasserman in the principal amount of \$100,000, secured by 1,000 shares of Wasserman-Gattmann Co., 500 of which shares were held by Petitioner and 500 of which shares were held by said Sherwood Swan.

2. On or about March 12, 1930 Petitioner and Sherwood Swan entered into an agreement with

Bank of America National Trust and Savings Association and the Central National Bank of Oakland, under which Petitioner and Sherwood Swan pledged to each of said [8] banks as security for their obligations to such banks, referred to in paragraph 1 above, 1,225 shares of said Wasserman-Gattmann Co. and 2,000 shares of Swan's (a corporation), held by Petitioner and Sherwood Swan jointly, and Petitioner and Sherwood Swan also pledged with each of said banks 500 shares of Sherwood Swan and Company, Ltd. held by Petitioner and Sherwood Swan jointly; subject, however, to said pledge thereof to Harrison S. Robinson to secure the payment of said note in the amount of \$35,000, and under which each of said banks absolutely and unconditionally agreed that it would look to said 500 shares of Sherwood Swan and Company, Ltd. so pledged with it for the payment of only \$100,000 amount of the indebtedness owing to it by Petitioner and said Sherwood Swan, or either of them, and amounts advanced by the bank to pay said note to Harrison S. Robinson, and that upon the payment of said sum of \$100,000 on account of said indebtedness and the payment of any amounts advanced by said bank to pay said note of Harrison S. Robinson, said 500 shares of Sherwood Swan and Company, Ltd. would be free from pursuit on account of any and all indebtedness owing to it by Petitioner and Sherwood Swan, or either of them.

3. Each of said banks paid one-half of said indebtedness owing to Harrison S. Robinson and prior

to December 16, 1936 Petitioner and Sherwood Swan paid to each of said banks the amount advanced by it to pay said indebtedness to Harrison S. Robinson and paid \$10,933.67 on account of the principal of said \$100,000 of said indebtedness owing to it by Petitioner [9] and Sherwood Swan. That in connection with the cancellation and settlement of indebtedness on December 16, 1936, referred to in the notice of deficiency attached hereto as Exhibit A, Petitioner and Sherwood Swan paid to each of said banks the remaining balance of said \$100,000. That consequently the release of said 500 shares was within the contemplation of said agreement of March 12, 1930.

4. That after said cancellation and settlement of indebtedness on December 16, 1936, Petitioner had no assets other than said 500 shares of said Sherwood Swan and Company, Ltd., and the liabilities of Petitioner (other than the liabilities in the aggregate amount of \$195,000 incurred in connection with the payment of said indebtedness to said banks) consisted of joint accounts payable by Petitioner and Sherwood Swan to Anglo California National Bank in the amount of \$5,000 and to Orrick, Palmer & Dahlquist in the amount of \$2,000.

5. That consequently no assets of Petitioner were released from the burden of said indebtedness to Bank of America National Trust and Savings Association and Central National Bank of Oakland by operation of said cancellation and settlement of indebtedness on December 16, 1936 which had not

already been released by said agreement of March 12, 1930. That in view of the foregoing, Petitioner did not derive any benefit whatsoever by reason or by virtue of the cancellation and settlement of indebtedness on December 16, 1936. [10]

In support of assignment of error (b) above:

6. That the cost to Petitioner of said 500 shares of Sherwood Swan and Company, Ltd. was \$50,000; that at the time of the cancellation and settlement of said indebtedness on December 16, 1936, the fair market value of said shares was considerably in excess of \$50,000; that under the provisions of the Revenue Act of 1936, upon the sale of said 500 shares of Sherwood Swan and Company, Ltd. (including shares received by Petitioner in exchange therefor in connection with the tax-free reorganization of said Sherwood Swan and Company, Ltd. hereinafter referred to) Petitioner would realize a taxable gain computed on the basis of said cost of \$50,000; that if Petitioner were required to take into account in computing net income for the calendar year 1936 the amount of any benefit derived from said cancellation and settlement of indebtedness on December 16, 1936 computed (among other things) on the basis of said fair market value of said 500 shares of Sherwood Swan and Company, Ltd.

(i) Petitioner would in fact be subject to two income taxes on the same income and value, i. e., a tax on the increase in value of said 500 shares of Sherwood Swan and Company, Ltd.



over their cost on account of said benefit derived from said cancellation and settlement of indebtedness and a tax on such increase on the sale of said shares; and

(ii) Petitioner would be taxed on an unrealized gain arising in connection with the increase in value of said 500 shares of Sherwood Swan and Company, Ltd. over the cost thereof not representing taxable income and not subject to taxation under the Revenue Act of 1936 or the Sixteenth Amendment to the Constitution of the United States. [11]

That no benefit would result to Taxpayer on account of said cancellation and settlement of indebtedness on December 16, 1936 if, for the purpose of computing the same, there is assigned to said 500 shares of Sherwood Swan and Company, Ltd. a value equal to said cost thereof in the amount of \$50,000.

In support of assignment of error (c) above:

7. That during the calendar year 1936 Petitioner did not sell or enter into any contract to sell any shares of Sherwood Swan and Company, Ltd., except as is hereinafter more particularly set forth in this paragraph 7. That prior to December 21, 1936 Petitioner held 500 shares of Sherwood Swan and Company, Ltd. and that the cost of said shares to Petitioner was \$50,000. That on December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd. Petitioner exchanged said 500 shares of Sher-

wood Swan and Company, Ltd. for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd. That at the time of said exchange the fair market value of said 15,000 Class A shares was \$105,000 and the fair market value of said 22,500 common shares was not in excess of \$43,092.50. That the portion of said cost of \$50,000 allocable to said 15,000 Class A shares was not less than \$35,450.81. That on November 18, 1936, Petitioner entered into a contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of "Robert N. Miller & Co." for the sale [12] to said purchasers of 12,500 Class A shares of Sherwood Swan and Company, Ltd. at a price of \$7 per share and a total price of \$87,500. That said purchasers, pursuant to said contract, during the calendar year 1936 purchased from Petitioner 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750, and during the calendar year 1937 purchased 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750. That consequently, during the calendar year 1936, Petitioner sold only 6,250 of said Class A shares for said total purchase price of \$43,750. That the cost allocable to said 6,250 Class A shares was not in excess of \$14,771.17 and that the gain derived from the sale thereof by Petitioner was not in excess of \$28,978.83.

In support of assignment of error (d) above:

Petitioner obtained extensions to June 1, 1937, to file his return for the calendar year 1936. Petitioner verily believes that said return was filed by

him on June 1, 1937. That said return was prepared for Petitioner by his accountants, Messrs. Barrow, Wade, Guthrie & Co., Certified Public Accountants. That by reason of the complexity of the matters covered by said return, a considerable amount of time was required to prepare it. That as soon as said return had been prepared Petitioner signed and verified it and filed it with the Collector of Internal Revenue. [13]

Wherefore, Petitioner prays that this Board may hear the proceeding and determine that there was a deficiency of \$177.65 and no penalty due from Petitioner for the year 1936.

HILLYER BROWN

CHAS. L. BARNARD

Counsel for Petitioner. [14]

State of California,  
City and County of San Francisco—ss.

W. R. Whitthorne, being duly sworn, says that he is the Petitioner above named; that he has read the foregoing Petition, and is familiar with the statements contained therein, and that the facts stated are true.

W. R. WHITTHORNE

Subscribed and sworn to before me this 12th day of January, 1940.

[Seal]

ANNE F. SWIFT,

Notary Public in and for the City and County of  
San Francisco, State of California. [15]

## EXHIBIT A

Letterhead of  
Treasury Department  
Internal Revenue Service  
San Francisco, Calif.

Oct. 20, 1939

IRA:90-D

LB

Mr. W. R. Whitthorne,  
324 Pacific Avenue,  
Oakland, California

Sir:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1936, and December 31, 1937, discloses a deficiency of \$9,952.27 and \$495.12 in penalty, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Room 433, Federal Office Building, Civic Center, San



San Francisco, California, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

(Signed) By F. M. HARLESS

Internal Revenue Agent in  
Charge.

H.J.B. (Signed)

Enclosures:

Statement

Form of Waiver [16]

Statement

San Francisco

IRA:90-D

LB

Mr. W. R. Whitthorne,

324 Pacific Avenue,

Oakland, California.

Tax Liability for the Taxable Years Ended December 31, 1936 and December 31, 1937.

	Liability	Assessed	Deficiency
Income Tax 1936.....	\$9,902.53	None	\$9,902.53
1937.....	958.46	\$908.72	49.74
Penalty 1936.....	\$ 495.12	None	\$ 495.12

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 6, 1939, to your protest dated April 14, 1939 and to the statements made at the conference held on May 16, 1939.

Your income tax return for the year 1936 was filed on June 2, 1937, whereas an extension granted to you by the Collector of Internal Revenue expired on June 1, 1937. Inasmuch as your income tax return was not filed within the time prescribed by law, or prescribed by the Commissioner in pursuance of law, five per centum of the tax has been added thereto in accordance with the provisions of Section 291, Revenue Act of 1936. [17]

#### ADJUSTMENTS TO NET INCOME

Year: 1936

Net income as disclosed by return.....	\$1,280.60
Unallowable deductions and additional income	
(a) Forgiveness of indebtedness.....	\$35,040.66
(b) Capital gain increased.....	21,895.25
Total .....	\$56,935.91
	<hr/>
	\$58,216.51
Nontaxable income and additional deductions	
(c) Interest paid .....	\$ 5,103.59
	5,103.59
	<hr/>
Net income adjusted.....	\$53,112.92

### Explanation of Adjustments

(a) On December 16, 1936, there was effected a settlement of the loan liabilities of yourself and Mr. Sherwood Swan to the Central National Bank of Oakland and the Bank of America N. T. & S. A., whereby principal indebtedness aggregating \$339,-147.65 was cancelled in consideration of the payment of \$175,000.00 cash and the transfer of certain stocks pledged as collateral on the loans.

Reportable profits on this transaction have been computed as follows: [18]

Creditor	Total loan Liabilities	Sherwood Swan	W. R. Whitthorne
Bank of America N.T. & S.A.....	\$65,000.00	\$65,000.00	
Bank of America.....	89,066.33	44,533.16	\$44,533.17
Total .....	<u>\$154,066.33</u>	<u>\$109,533.16</u>	<u>\$44,533.17</u>
<b>Payments</b>			
Cash .....	\$100,000.00	\$ 50,000.00	\$50,000.00
2071 shares Hale Brothers Realty...	34,564.69	34,564.69	—
1225 shares Wasserman-Gattman.....	No value	—	—
2000 shares Swan's.....	No value	—	—
Total .....	<u>\$134,564.69</u>	<u>\$84,564.69</u>	<u>\$50,000.00</u>
Profit realized (loss).....	\$ 19,501.64	\$24,968.47	\$(5,466.83)

There is omitted from this calculation accrued but unpaid interest for the current year and prior years of \$35,773.47 and a loan liability of the Wasserman-Gattman Company of \$6,233.34 for which Swan and Whitthorne had only a contingent liability.

Creditor	Total loan Liabilities	Sherwood Swan	W. R. Whitthorne
Central National Bank of Oakland...	\$165,081.32	\$82,540.66	\$82,540.66
Central National Bank of Oakland...	20,000.00	20,000.00	—
Total .....	\$185,081.32	\$102,540.66	\$82,540.66
<b>Payments</b>			
Cash .....	\$ 75,000.00	\$ 37,500.00	\$37,500.00
New note of Swan and Whitthorne	20,000.00	10,000.00	10,000.00
Total .....	\$ 95,000.00	\$ 47,500.00	\$47,500.00
Profit realized .....	\$ 90,081.32	\$ 55,040.66	\$35,040.66
Total profit (loss) through both transactions .....	\$109,582.96	\$ 80,009.13	\$35,040.66 \$(5,466.83)

(There is omitted from this calculation, accrued but unpaid interest for the current and prior years of \$27,033.72).

[19]

In effecting the settlement, the Central National Bank of Oakland released 500 shares of Sherwood Swan and Company, Ltd., and the Bank of America also released 500 shares of Sherwood Swan and Company, Ltd., which had been deposited by the joint debtors. However, the Bank of America withheld and assumed title to 1225 shares of Wasserman-Gattman Company, 2,000 shares Swan's and 2071 shares of Hale Brothers Realty Company. To effect this transfer a pledgee's sale was held and the creditor ostensibly bought in these stocks for \$96,073.14, which represented the unpaid balance of the Bank of America loans plus accrued interest. However, at this time, stocks in the Wasserman-Gattman Company, and Swan's, Inc. were entirely worthless, while the market value of the 2071 shares

of Hale Brothers Realty Company stock was \$34,564.69. Since the transaction was negotiated and agreed to on the basis of a cancellation of the unpaid note balances, over and above the value of the stocks surrendered, the pledge sale at the artificial figure of \$96,073.14 is disregarded; credit is given for a payment by Sherwood Swan and yourself equivalent to \$34,564.69, the market value of 2071 shares of Hale Brothers Realty Company stock. The unpaid balance of \$19,501.64, represents a cancellation of \$24,968.47 in favor of Sherwood Swan offset by a payment of \$5,466.83 by you in excess of principal due from you but applying on unpaid interest due from you.

The benefit from cancellation of your indebtedness in the amount of \$35,040.66 as shown, is held to be taxable income in accordance with Article 22(a)-14 of Treasury Regulations 94 and *Walker v. Comm.* 88 Fed. (2) 170.

(b) Your reportable capital gain is revised as follows:

	Per return	Revised
Profit on one-half interest in 1,000 shares Sherwood, Swan and Company Ltd. ....	\$19,895.25	\$19,895.25
Loss, one-half interest in 1,225 shares Wasserman-Gattman Company .....	(30,549.91)	None
Loss, one-half interest in 2,000 shares Swan's, Inc. ....	( 9,969.35)	None
Net .....	\$(20,624.01)	\$19,895.25
Add: Limited deduction claimed on return.....		2,000.00
Total increase in reportable income.....		<u>\$21,895.25</u>



Although the stocks in Wasserman, Gattman Company, and Swan's, Inc. were transferred to the Bank of America N. T. S. A. in connection with the debt settlement, such stocks had no value at the time. No loss on the transfer is allowable for the reason that such stocks were determined worthless prior to the taxable year. The holding that such stocks were worthless is based on the fact that in his 1933 return, Sherwood Swan claimed a deduction due to worthlessness of stock in the Wasserman-Gattman Company, which was disallowed by the Commissioner on the ground that this stock became worthless in the year 1930. Since the only asset of Swan's, Inc. was holdings of stock in the Wasserman-Gattman Company, it, too, is held to have become worthless in 1930.

(c) Since the debt settlement with the Bank of America N. T. S. A. you paid \$5,466.83 more than the amount of your principal liability, such excess is considered as a partial payment of the accrued interest and a deduction therefor allowed. Offsetting such allowance, the interest deduction of \$363.24 claimed on your return as paid in connection with this settlement is eliminated, leaving a net additional allowance of \$5,103.59. [21]

## COMPUTATION OF TAX

Year: 1936

Net income adjusted.....	\$53,112.92
Less:	
Personal exemption .....	\$2,500.00
	<hr/> 2,500.00
Balance (surtax net income).....	\$50,612.92
Less:	
Earned income credit.....	300.00
	<hr/>
Net income subject to normal tax.....	\$50,312.92
Normal tax at 4% on \$50,312.92.....	\$ 2,012.52
Surtax on \$50,612.92.....	7,890.01
	<hr/>
Correct income tax liability.....	\$ 9,902.53
Income tax assessed:	
Original, First California, Account No. 684,430	None
Deficiency of income tax.....	\$ 9,902.53
Penalty of 5%, Section 291 Revenue Act of 1936	\$ 495.12
Penalty assessed .....	None
	<hr/>
Deficiency .....	\$ 495.12

## ADJUSTMENTS TO NET INCOME

Year: 1937

Net income as disclosed by return.....	\$14,506.02
Unallowable deductions and additional income	
(a) Capital gain increased.....	\$414.46
	<hr/> 414.46
Net income adjusted.....	\$14,920.48

[22]

## Explanation of Adjustments

(a) In 1937, you transferred to Sherwood Swan 4,500 shares of Sherwood Swan & Co. Ltd., common stock in exchange for his assumption of your note liabilities. Capital gain from this transaction is computed as follows:

Your liability on joint non-interest bearing note of \$20,000.00 executed 12/16/1936.....	\$10,000.00
Your liability on joint interest bearing note of \$10,000.00 .....	5,000.00
Total proceeds to you.....	\$15,000.00
Cost: 4500 shares Sherwood Swan & Co. Ltd., com- mon stock at \$1.0924 per share.....	4,915.80
Profit realized .....	\$10,084.20
Reportable under provisions of Section 117, Reve- nue Act of 1936, since stock held over ten years, 30% .....	\$ 3,025.26
Gain reported in return.....	2,610.80
Increase .....	\$ 414.46
	[23]

## COMPUTATION OF TAX

Year: 1937

Net income adjusted.....	\$14,920.48
Less:	
Personal exemption .....	\$2,500.00      2,500.00
Balance (surtax net income).....	\$12,420.48
Less:	
Earned income credit.....	300.00
Net income subject to normal tax.....	\$12,120.48
Normal tax at 4% on \$12,120.48.....	\$ 484.82
Surtax on                      \$12,420.48.....	473.64
Correct income tax liability.....	\$ 958.46
Income tax assessed:	
Original, First California, Account No. 200,111, May 1938.....	908.72
Deficiency of income tax.....	\$ 49.74

[Endorsed]: Filed Jan. 16, 1940. [24]



[Title of Board and Cause—Docket No. 101189.]

FIRST AMENDMENT TO PETITION

The petition of W. R. Whitthorne filed in the above entitled matter for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D/LB), dated October 20, 1939, is amended as follows:

1.

Paragraph III of said petition is amended to read:

“The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$9,724.88 and penalty in the amount of \$495.12.”

2.

Subparagraph (a) of paragraph IV of said petition is amended to read:

“(a) The Commissioner erred in finding that Petitioner received any benefit whatsoever in the calendar year 1936 by the cancellation during said calendar year of the [25] indebtedness owing by him to Central National Bank of Oakland in the sum of \$35,040.66, since the benefit arose from a transaction which took place in the calendar year 1930.”

Dated: January 17, 1940.

HILLYER BROWN

CHAS. L. BARNARD

Counsel for Petitioner. [26]

State of California,  
County of Alameda—ss.

W. R. Whitthorne, being duly sworn, says that he is the Petitioner above named; that he has read the foregoing First Amendment to Petition, and is familiar with the statements contained therein, and that the facts stated are true.

W. R. WHITTHORNE.

Subscribed and sworn to before me this 17th day of January, 1940.

(Seal) BESSIE E. COTTON,  
Notary Public in and for the County of Alameda,  
State of California.

[Endorsed]: Filed Jan. 19, 1940. [27]

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[Title of Board and Cause—Docket No. 101189.]

### ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition, as amended, filed by the above-named petitioner admits and denies as follows:

I. Admits the allegations contained in paragraph I of the petition as amended.

II. Admits the allegations contained in paragraph II of the petition as amended.

III. Admits that the tax in controversy is income tax for the calendar year 1936; denies the re-

maining allegations contained in paragraph III of the petition as amended.

IV(a) to (d), incl. Denies that the Commissioner erred as alleged in subparagraphs (a) to (d), inclusive, of paragraph IV of the petition as amended. [28]

V-1. For lack of materiality, denies all allegations contained in subparagraph 1 of paragraph V of the petition as amended.

V-2. For lack of materiality, denies all allegations contained in subparagraph 2 of paragraph V of the petition as amended.

V-3. Admits that on December 16, 1936, there was a cancellation and settlement of the indebtedness referred to in the notice of deficiency attached to the petition as Exhibit A; denies the remaining allegations contained in subparagraph 3 of paragraph V of the petition as amended.

V-4 and V-5. Denies all allegations contained in subparagraphs 4 and 5 of paragraph V of the petition as amended.

V-6. Admits that the cost to petitioner of 500 shares of Sherwood Swan and Company, Ltd., stock was \$50,000; that at the time of the cancellation and settlement of said indebtedness on December 16, 1936, the fair market value of said shares was considerably in excess of \$50,000; denies the remaining allegations contained in subparagraph 6 of paragraph V of the petition as amended.

V-7. Admits that prior to December 21, 1936, petitioner held 500 shares of Sherwood Swan and

Company, Ltd., stock; that the cost of said shares to petitioner was \$50,000; that on December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd., petitioner exchanged said 500 shares of [29] Sherwood Swan and Company, Ltd., stock for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd., stock; that on November 18, 1936, petitioner entered into a certain contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of "Robert N. Miller & Co.," for the sale to said purchasers of certain Class A shares of Sherwood Swan and Company, Ltd., at a price of \$7 per share, denies the remaining allegations contained in subparagraph 7 of paragraph V of the petition as amended.

VI. Admits that petitioner obtained extensions until June 1, 1937, to file his income tax return for the calendar year 1936; denies the remaining allegations set forth in the petition as amended under the heading "In support of assignment of error (d) above."

VII. Denies generally and specifically each and every allegation in the petition as amended not herebefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's

determination be approved and petitioner's appeal denied.

J. P. WENCHEL,  
Chief Counsel, Bureau of  
Internal Revenue.

Of Counsel:

ALVA C. BAIRD,  
T. M. MATHER,  
HARRY R. HORROW,  
Special Attorneys,  
Bureau of Internal Revenue.

[Endorsed]: Filed Feb. 15, 1940. [30]

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[Title of Board and Cause—Docket No. 101189.]

## SECOND AMENDMENT TO PETITION

The petiton of W. R. Whitthorne filed in the above entitled matter for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D/LB, dated October 20, 1939, is amended as follows by Minnie L. Whitthorne and Eva Whitthorne, Executrices of the Estate of W. R. Whitthorne, the original petitioner herein:

### I.

Paragraph III of said Petition is amended to read:

“The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$9,812.45 and penalty in the amount of \$495.12.”



## II.

Paragraph IV of said Petition is amended by inserting at the end of subparagraph (b) thereof a new subparagraph numbered (b-1) to read as follows: [31]

“(b-1) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, and even if cancellation of indebtedness under the circumstances hereinafter alleged constituted taxable income, said income could not have exceeded the sum of \$4,000.00 and consequently the Commissioner erred in finding that the income to Petitioner from said cancellation was in the amount of \$35,040.66.”

## III.

Paragraph IV(c) of said Petition is amended to read:

“(c) The Commissioner erred in finding that during the calendar year 1936 Petitioner sold a one-half interest in 1,000 shares of Sherwood Swan and Company, Ltd., and in finding that the cost or other basis of said 1,000 shares was \$42,365 and in finding that said 1,000 shares were sold for an aggregate sum of \$175,000, or any other sum whatsoever, and in finding that Petitioner's share of the profit from such sale was \$66,317.50, or any other sum whatsoever. However, Petitioner sold, during said calendar year 1936, 6,250 Class A shares of Sherwood

Swan and Company, Ltd., for an aggregate selling price of \$43,750. The cost allocable to said 6,250 Class A shares was \$20,833.33 and Taxpayer realized a gain of \$22,916.67 on said sale of Class A shares.”

#### IV.

Subparagraph 1.(i) of paragraph V of said Petition is amended to read:

“(i) An account receivable due from Sherwood Swan and Company, Ltd., in the amount of \$5,506.09;”

#### V.

Paragraph V is amended by inserting at the end of subparagraph 6 thereof a new subparagraph numbered 6(a) to read as follows: [32]

“In support of assignment of error (b-1) above:

“6(a) That immediately after the cancellation and settlement of indebtedness on December 16, 1936, referred to in said notice of deficiency, a copy of which is attached hereto and marked ‘Exhibit A,’ Petitioner’s assets consisted of:

500 shares of Sherwood Swan and Company Ltd., having a fair market value of not in excess of \$105,000 and the liabilities of Petitioner consisted of:

(i) Joint note of Petitioner and Sherwood Swan to The Anglo California National Bank in the principal amount of \$175,000;



(ii) Joint note of Petitioner and Sherwood Swan to the Central Company in the principal amount of \$20,000;

(iii) Joint account payable by Petitioner and said Sherwood Swan to Orrick, Palmer & Dahlquist in the amount of \$2,000; and

(iv) Joint obligation of Petitioner and said Sherwood Swan to Anglo California National Bank in the amount of \$5,000.

That the aggregate value of said assets of Petitioner was \$105,000 and that the aggregate amount of Petitioner's said liabilities (including, in the case of joint obligations, only Petitioner's one-half thereof) was \$101,000 and that the amount by which the value of Petitioner's said assets exceeded the amount of his said liabilities was \$4,000.

That by reason of the foregoing, if Petitioner derived any benefit from said cancellation and settlement of indebtedness on December 16, 1936, such benefit was not in excess of \$4,000." [33]

## VI.

Subparagraph 7 of paragraph V of said Petition is amended to read:

"In support of assignment of error (c) above:

"7. That during the calendar year 1936 Petitioner did not sell or enter into any contract to sell any shares of Sherwood Swan and Company, Ltd., except as is hereinafter more particularly set forth in this paragraph 7. That

prior to December 21, 1936, Petitioner held 500 shares of Sherwood Swan and Company, Ltd., and that the cost of said shares to Petitioner was \$50,000. That on December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd., Petitioner exchanged said 500 shares of Sherwood Swan and Company, Ltd., for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd. That at the time of said exchange the fair market value of said 15,000 Class A shares was \$105,000 and the said 22,500 common shares had no fair market value. That all of said cost of \$50,000 was allocable to said 15,000 Class A shares. That on November 18, 1936, Petitioner entered into a contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of 'Robert N. Miller & Co.' for the sale to said purchasers of 12,500 Class A shares of Sherwood Swan and Company, Ltd., at a price of \$7 per share and a total price of \$87,500. That said purchasers, pursuant to said contract, during the calendar year [34] 1936 purchased from Petitioner 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750, and during the calendar year 1937 purchased 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750. That consequently, during the calendar year 1936, Petitioner sold only 6,250 of said Class A shares for said total purchase price of \$43,750. That the cost allocable to said

6,250 Class A shares was not in excess of \$20,833.33 and that the gain derived from the sale thereof by Petitioner was not in excess of \$22,916.67.”

## VII.

The prayer of said Petition is amended to read:

“Wherefore, Petitioner prays that this Board may hear the proceeding and determine that there is a deficiency of \$90.08 and no penalty due from Petitioner for the year 1936.

ROBERT W. MACDONALD,

Counsel for Petitioner.

1600 Financial Center Bldg.  
Oakland, California. [35]

State of California,  
County of Alameda—ss.

Eva Whitthorne, being duly sworn, deposes and says: That she is one of the Executrices of the Estate of the Petitioner above named; that she has read the foregoing Second Amendment to Petition, and is familiar with the statements contained therein, and that the facts stated are true.

EVA WHITTHORNE.

Subscribed and sworn to before me this 17th day of October, 1940.

(Seal)

A. McCREADY,

Notary Public in and for the County of Alameda,  
State of California.

[Endorsed]: Filed Oct. 21, 1940 [36]

[Title of Board and Cause—Docket No. 101189.]

ORDER

On suggestion of death of the petitioner and notice of the appointment of Executrices filed in the above-entitled proceeding, it is

Ordered: That Minnie L. Whitthorne and Eva Whitthorne, Executrices of the Estate of W. R. Whitthorne, deceased, be and they hereby are substituted in the place and stead of W. R. Whitthorne, deceased, and that henceforth the title of this proceeding shall be Estate of W. R. Whitthorne, deceased, Minnie L. Whitthorne and Eva Whitthorne, Executrices, Petitioners, v. Commissioner of Internal Revenue, Respondent.

(Signed) J. M. STERNHAGEN  
Member.

Dated: San Francisco, Calif., October 21, 1940.

[37]

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[Title of Board and Cause—Docket No. 101189.]

ANSWER TO SECOND AMENDMENT TO  
PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the Second Amendment to Petition filed by the above-named petitioner, admits and denies as follows:



## I.

Admits the allegations contained in paragraph I of the Second Amendment to Petition, except as to the amount of income taxes in controversy, which is denied.

## II.

Denies the allegations contained in paragraph II of the Second Amendment to Petition. [38]

## III.

Denies the allegations contained in paragraph III of the Second Amendment to Petition.

## IV.

Denies the allegations contained in paragraph IV of the Second Amendment to Petition.

## V.

Denies the allegations contained in paragraph V of the Second Amendment to Petition.

## VI.

Denies the allegations contained in paragraph VI of the Second Amendment to Petition.

## VII.

Denies generally and specifically each and every allegation in the Second Amendment to the Petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's

determination be approved and that the petitioner's appeal be denied.

J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel.

T. M. MATHER,

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: Filed Oct. 31, 1940 [39]

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United States Board of Tax Appeals

Docket No. 101190

SHERWOOD SWAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

### PETITION

The above named Petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-D/LB), dated October 20, 1939, and as a basis of his proceeding alleges as follows:

## I.

Petitioner is an individual with residence in the City of Oakland, County of Alameda, State of California.

## II.

That a notice of deficiency (a copy of which is attached hereto and marked Exhibit A) was mailed to Petitioner on October 20, 1939.

## III.

The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$44,854.91 and penalty in the amount of \$2,242.74. [40]

## IV.

The determination of the tax set forth in the said notice of deficiency is based upon the following errors and each thereof:

(a) The Commissioner erred in finding that Petitioner received any benefit whatsoever in the calendar year 1936 by the cancellation during said calendar year of the indebtedness owing by him to Bank of America National Trust and Savings Association and Central National Bank of Oakland in the aggregate sum of \$80,009.13 and the respective sums of \$24,968.47 and \$55,040.66, since the benefit arose from a transaction which took place in the calendar year 1930.

(b) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, the Commissioner nevertheless



erred in holding and determining that the benefit to Petitioner from said cancellation of indebtedness, or any part thereof, constituted taxable income to Petitioner as, under the circumstances hereinafter alleged, said cancellation of indebtedness is not income within the meaning of the Revenue Act of 1936 or the Sixteenth Amendment to the Constitution.

(c) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, and even if cancellation of indebtedness under the circumstances hereinafter alleged constituted taxable income, said income could not have exceeded the sum of \$24,270.14 [41] and consequently the Commissioner erred in finding that the income to Petitioner from said cancellation was in the amount of \$80,009.13.

(d) The Commissioner erred in finding that during the calendar year 1936 Petitioner sold a one-half interest in 1,000 shares of Sherwood Swan and Company, Ltd. and is finding that the cost or other basis of said 1,000 shares was \$42,365 and in finding that said 1,000 shares were sold for an aggregate sum of \$175,000, or any other sum whatsoever, and in finding that Petitioner's share of the profit from such sale was \$66,317.50, or any other sum whatsoever. However, Petitioner sold, during said calendar year 1936, 6,250 Class A shares of Sherwood Swan and Company, Ltd. for an aggregate selling price of \$43,750. The cost allocable to said 6,250 Class A shares was \$14,771.17 and Taxpayer

realized a gain of \$28,978.83 on said sale of Class A shares.

(e) The Commissioner erred in assessing against Petitioner a 5% penalty under Section 291 of the Revenue Act of 1936 on account of the alleged delinquent filing by Petitioner of his return for said calendar year. [42]

## V.

The facts upon which the Petitioner relies as the basis of this proceeding are as follows:

In Support of assignment of error (a) above:

1. In March 1930, Petitioner's assets consisted solely of:

(i) An account receivable due from Wasserman-Gattmann Co. in the amount of \$2,425.55;

(ii) 500 shares of Sherwood Swan and Company, Ltd.;

(iii) 2,071 shares of Hale Bros. Realty Co.;

(iv) 1,725 shares of Wasserman-Gattman Co.;

(v) 2,000 shares of Swan's (a corporation); and

(vi) a ranch situated in Madera County, California;

and the liabilities of Petitioner consisted of:

((i)) Joint note of Petitioner and W. R. Whitthorne to Harrison S. Robinson in the principal amount of \$35,000, secured by pledge of 1,000 shares of Sherwood Swan and Com-

pany, Ltd. (held by Petitioner and W. R. Whitthorne, jointly);

((ii)) Joint unsecured note of Petitioner and W. R. Whitthorne to Bank of America National Trust and Savings Association in the principal amount of \$100,000;

((iii)) Joint notes of Petitioner and W. R. Whitthorne to Central National Bank of Oakland in the aggregate principal amount of \$250,000, secured by 6,000 shares of Hale Bros. Stores, Inc., held by W. R. Whitthorne;

((iv)) Note of Petitioner to Bank of America National Trust and Savings Association in the principal amount of \$65,000, secured by said 2,071 shares of Hale Bros. Realty Co.;

((v)) Note of Petitioner to Central National Bank of Oakland in the amount of \$20,000;

((vi)) Note of Petitioner to Bank of America National Trust and Savings Association having a remaining [43] principal balance of \$10,000 secured by a mortgage on said ranch in Madera County; and

((vii)) Joint purchase money note of Petitioner and W. R. Whitthorne to David S. Wasserman in the principal amount of \$100,000, secured by 1,000 shares of Wasserman-Gattmann Co., 500 of which shares were held by Petitioner and 500 of which shares were held by said W. R. Whitthorne.

2. On or about March 12, 1930 Petitioner and W. R. Whitthorne entered into an agreement with Bank of America National Trust and Savings Association and the Central National Bank of Oakland, under which Petitioner and W. R. Whitthorne pledged to each of said banks, as security for their obligations to such banks, referred to in paragraph 1 above, 1,225 shares of said Wasserman-Gattmann Co. and 2,000 shares of Swan's (a corporation), held by Petitioner and W. R. Whitthorne jointly, and Petitioner and W. R. Whitthorne also pledged with each of said banks 500 shares of Sherwood Swan and Company, Ltd. held by Petitioner and W. R. Whitthorne jointly; subject, however, to said pledge thereof to Harrison S. Robinson to secure the payment of said note in the amount of \$35,000, and under which each of said banks absolutely and unconditionally agreed that it would look to said 500 shares of Sherwood Swan and Company, Ltd. so pledged with it for the payment of only \$100,000 amount of the indebtedness owing to it by Petitioner and said W. R. Whitthorne, or either of them, and amounts advanced by such bank to pay said note to Harrison S. Robinson, and that upon the payment of said \$100,000 of indebtedness and the payment of any amounts advanced by said bank to pay said note of [44] Harrison S. Robinson, said 500 shares of Sherwood Swan and Company, Ltd. would be free from pursuit on account of any and all indebtedness owing to it by Petitioner and W. R. Whitthorne, or either of them.



3. Each of said banks paid one-half of said indebtedness owing to Harrison S. Robinson and prior to December 16, 1936, Petitioner and W. R. Whitthorne paid to each of said banks the amount advanced by it to pay said indebtedness to Harrison S. Robinson and paid \$10,933.67 on account of the principal of said \$100,000 of said indebtedness owing to it by Petitioner and W. R. Whitthorne. That in connection with the cancellation and settlement of indebtedness on December 16, 1936, referred to in the notice of deficiency attached hereto as Exhibit A, Petitioner and W. R. Whitthorne paid to each of said banks the remaining balance of said \$100,000. That consequently the release of said 500 shares was within the contemplation of said agreement of March 12, 1930.

4. That after said cancellation and settlement of indebtedness on December 16, 1936, Petitioner's assets (other than said 500 shares of Sherwood Swan and Company, Ltd.) consisted of:

(i) Said ranch situated in Madera County;  
and

(ii) An open book account due from Sherwood Swan and Company, Ltd. in the amount of \$8,091.12;

and that the liabilities of Petitioner (other than the liabilities in the aggregate amount of \$195,000 incurred in connection with the payment of said indebtedness to said banks) consisted of: [45]

((i)) Said indebtedness to Bank of America National Trust and Savings Association in

the amount of \$10,000, secured by said ranch in Madera County;

((ii)) An indebtedness to Harry Camp in the amount of \$7,500;

((iii)) A note to David S. Wasserman in the principal amount of \$5,000;

((iv)) Accounts payable to Helen L. Swan in the amount of \$4,788, and to Charles Raphael in the amount of \$500;

((v)) Joint accounts payable by Petitioner and W. R. Whitthorne to Anglo California National Bank in the amount of \$5,000 and to Orrick, Palmer & Dahlquist in the amount of \$2,000; and

((vi)) Accrued federal income tax and California state income tax liability for the year 1936 in the estimated amount of \$2,032.03.

5. That consequently the only assets of Petitioner that were released from the burden of said indebtedness to Bank of America National Trust and Savings Association and Central National Bank of Oakland by operation of said cancellation and settlement of indebtedness on December 16, 1936, which had not already been released by said agreement of March 12, 1930, were said ranch in Madera County and said account receivable from Sherwood Swan and Company, Ltd. That on December 16, 1936, the fair market value of said ranch in Madera County was \$6,000 and that the value of the assets of Petitioner so released by said cancellation and



settlement of indebtedness was \$14,091.12. That the aggregate amount of Petitioner's liabilities on December 16, 1936 (other than said notes in the amount of \$195,000 given in connection with the payment of said cancellation and settlement of indebtedness [46] and including only Petitioner's one-half liability on joint obligations) was \$33,320.03. That in view of the foregoing Petitioner did not derive any benefit whatsoever by reason or by virtue of the said cancellation and settlement of indebtedness on December 16, 1936.

In support of assignment of error (b) above:

6. That the cost to Petitioner of said 500 shares of Sherwood Swan and Company, Ltd. was \$50,000; that at the time of the cancellation and settlement of said indebtedness on December 16, 1936, the fair market value of said shares was considerably in excess of \$50,000; that under the provisions of the Revenue Act of 1936, upon the sale of said 500 shares of Sherwood Swan and Company, Ltd. (including shares received by Petitioner in exchange therefor in connection with the tax-free reorganization of said Sherwood Swan and Company, Ltd. hereinafter referred to) Petitioner would realize a taxable gain computed on the basis of said cost of \$50,000; that if Petitioner were required to take into account in computing net income for the calendar year 1936 the amount of any benefit derived from said cancellation and settlement of indebtedness on December 16, 1936 computed (among other things) on the basis of said fair market value of

said 500 shares of Sherwood Swan and Company, Ltd.

(i) Petitioner would in fact be subject to two income taxes on the same income and value, i. e., a tax on the increase in value of said 500 shares of Sherwood Swan and Company, Ltd. over their cost on account of said benefit derived from said cancellation [47] and settlement of indebtedness and a tax on such increase on the sale of said shares; and

(ii) Petitioner would be taxed on an unrealized gain arising in connection with the increase in value of said 500 shares of Sherwood Swan and Company, Ltd. over the cost thereof not representing taxable income and not subject to taxation under the Revenue Act of 1936 or the Sixteenth Amendment to the Constitution of the United States.

That no benefit would result to Taxpayer on account of said cancellation and settlement of indebtedness on December 16, 1936 if, for the purpose of computing the same, there is assigned to said 500 shares of Sherwood Swan and Company, Ltd. a value equal to said cost thereof in the amount of \$50,000.

In support of assignment of error (c) above:

7. That immediately after the cancellation and settlement of indebtedness on December 16, 1936, referred to in said notice of deficiency, a copy of

which is attached hereto and marked Exhibit A, Petitioner's assets consisted of:

(i) 500 shares of Sherwood Swan and Company, Ltd. having a fair market value of not in excess of \$148,092.50;

(ii) Said ranch in Madera County having a fair market value of \$6,000;

(iii) Accounts receivable owing by Sherwood Swan and Company, Ltd. in the amount of \$8,091.12;

and the liabilities of Petitioner consisted of:

((i)) Joint note of Petitioner and W. R. Whitthorne to the Anglo California National Bank in the principal amount of \$175,000;

((ii)) Joint note of Petitioner and W. R. Whitthorne to the Central Company in the principal amount of \$20,000; [48]

((iii)) Note of Petitioner to Bank of America National Trust and Savings Association having an unpaid principal balance of \$10,000, secured by a mortgage on said ranch in Madera County;

((iv)) Note of Petitioner to D. S. Wasserman in the amount of \$5,000;

((v)) Indebtedness of Petitioner to Harry Camp in the principal amount of \$7,500;

((vi)) Accounts payable of Petitioner to Helen L. Swan in the amount of \$4,788 and to Charles Raphael in the amount of \$500;

((vii)) Joint account payable of Petitioner

and said W. R. Whitthorne to Orrick, Palmer & Dahlquist in the amount of \$2,000;

((viii)) Joint obligation of Petitioner and said W. R. Whitthorne to Anglo California National Bank in the amount of \$5,000; and

((ix)) Accrued federal and California state income tax of Petitioner for the year 1936 (including taxes on income on benefit from cancellation of indebtedness) in the approximate amount of \$9,125.48.

That the aggregate value of said assets of Petitioner was \$162,183.62 and that the aggregate amount of Petitioner's said liabilities (including, in the case of joint obligations, only Petitioner's one-half share thereof) was \$137,913.48, and that the amount by which the value of Petitioner's said assets exceeded the amount of his said liabilities was \$24,270.14.

That by reason of the foregoing, if Petitioner derived any benefit from said cancellation and settlement of indebtedness on December 16, 1936, such benefit was not in excess of \$24,270.14.

In support of assignment of error (d) above:

8. That during the calendar year 1936 Petitioner [49] did not sell or enter into any contract to sell any shares of Sherwood Swan and Company, Ltd., except as is hereinafter more particularly set forth in this paragraph 8. That prior to December 21, 1936 Petitioner held 500 shares of Sherwood Swan and Company, Ltd. and that the cost of said shares



to Petitioner was \$50,000. That on December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd. Petitioner exchanged said 500 shares of Sherwood Swan and Company, Ltd. for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd. That at the time of said exchange the fair market value of said 15,000 Class A shares was \$105,000 and the fair market value of said 22,500 common shares was not in excess of \$43,092.50. That the portion of said cost of \$50,000 allocable to said 15,000 Class A shares was not less than \$35,450.81. That on November 18, 1936, Petitioner entered into a contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of "Robert N. Miller & Co." for the sale to said purchasers of 12,500 Class A shares of Sherwood Swan and Company, Ltd. at a price of \$7 per share and a total price of \$87,500. That said purchasers, pursuant to said contract, during the calendar year 1936 purchased from Petitioner 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750, and during the calendar year 1937 purchased 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750. That consequently, during [50] the calendar year 1936, Petitioner sold only 6,250 of said Class A shares for said total purchase price of \$43,750. That the cost allocable to said 6,250 Class A shares was not in excess of \$14,771.17 and that the gain derived from

the sale thereof by Petitioner was not in excess of \$28,978.83.

In support of assignment of error (e) above:

Petitioner obtained extensions to June 1, 1937, to file his return for the calendar year 1936. Petitioner verily believes that said return was filed by him on June 1, 1937. That said return was prepared for Petitioner by his accountants, Messrs. Barrow, Wade, Guthrie & Co., Certified Public Accountants. That by reason of the complexity of the matters covered by said return a considerable amount of time was required to prepare it. That as soon as said return had been prepared Petitioner signed and verified it and filed it with the Collector of Internal Revenue.

Wherefore, Petitioner prays that this Board may hear the proceeding and determine that the deficiency due from the Petitioner for the year 1936 is \$3,318.74 and that there is no penalty due from Petitioner for said year.

HILLYER BROWN

CHAS. L. BARNARD

Counsel for Petitioner. [51]

State of California,

City and County of San Francisco—ss.

Sherwood Swan, being duly sworn, says that he is the Petitioner above named; that he has read the foregoing Petition, and is familiar with the



statements contained therein, and that the facts stated are true.

SHERWOOD SWAN

Subscribed and sworn to before me this 12th day of January, 1940.

[Seal]

ANNE F. SWIFT,

Notary Public in and for the City and County of San Francisco, State of California. [52]

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EXHIBIT A

Treasury Department  
Internal Revenue Service  
San Francisco, Calif.

Oct. 20, 1939.

Office of  
Internal Revenue Agent in Charge  
433 Federal Office Building  
San Francisco Division  
IRA:90-D  
LB

Mr. Sherwood Swan,  
244 Lakeside Drive,  
Oakland, California.

Sir:

You are advised that the determination of your income tax liability for the taxable year ended December 31, 1936, discloses a deficiency of \$44,854.91 and \$2,242.74 in penalty, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Room 433, Federal Office Building, Civic Center, San Francisco, California, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,

Commissioner,

By: F. M. HARLESS

Internal Revenue Agent in  
Charge.

H.F.B.

Enclosures:

Statement

Form of Waiver [53]

STATEMENT

San Francisco

IRA :90-D

LB

Mr. Sherwood Swan,  
244 Lakeside Drive,  
Oakland, California.

Tax Liability for the Taxable Year Ended  
December 31, 1936.

	Liability	Assessed	Deficiency
Income Tax .....	\$44,854.91	None	\$44,854.91
Penalty .....	\$ 2,242.74	None	\$ 2,242.74

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 6, 1939, to your protest dated April 14, 1939 and to the statements made at the conference held on May 16, 1939.

Inasmuch as your income tax return was not filed within the time prescribed by law or prescribed by the Commissioner in pursuance of law, five per centum of the tax has been added thereto in accordance with the provisions of Section 291, Revenue Act of 1936.

ADJUSTMENTS TO NET INCOME

Net income (loss) as disclosed by return.....		\$(14,326.19)
Unallowable deductions and additional income		
(a) Forgiveness of indebtedness.....	\$80,009.13	
(b) Capital gain increased.....	22,225.36	
(c) Interest .....	32,575.52	134,810.01
	<hr/>	<hr/>
Net income adjusted.....		\$120,483.82
		<hr/>

## EXPLANATION OF ADJUSTMENTS

(a) On December 16, 1936, there was effected a settlement of the loan liabilities of yourself and W. R. Whitthorne, to the Central National Bank of Oakland, and the Bank of America N. T. & S. A., whereby principal indebtedness aggregating \$339,147.65 was cancelled in consideration of the payment of \$175,000.00 cash, the execution of a new promissory note of \$20,000.00 and the transfer of certain stock pledged as collateral on the loans.

Reportable profit on this transaction has been computed as follows:

Creditor	Total loan Liabilities	Sherwood Swan	W. R. Whitthorne
Bank of America N.T. & S.A.....	\$65,000.00	\$65,000.00	\$
Bank of America.....	89,066.33	44,533.16	44,533.17
Total .....	<u>\$154,066.33</u>	<u>\$109,533.16</u>	<u>\$44,533.17</u>
<b>Payments:</b>			
Cash .....	\$100,000.00	\$50,000.00	\$50,000.00
2071 shares Hale Brothers Realty Company .....	34,564.69	34,564.69	
1225 shares Wasserman-Gattman Co. ....	No value	—	—
2000 shares Swan's.....	No value		
Total .....	<u>\$134,564.69</u>	<u>\$84,564.69</u>	<u>\$50,000.00</u>
Profit realized .....	\$ 19,501.64	\$24,968.47	\$(5,466.83)

There is omitted from this calculation accrued but unpaid interest for the current year and prior years of \$35,773.47 and a loan liability of the Wasserman-Gattman Company of \$6,233.24 for which Swan and Whitthorne had only a contingent liability.

Creditor	Total loan Liabilities	Sherwood Swan	W. R. Whitthorne
Central National Bank of Oakland...	\$165,081.32	\$82,540.66	\$82,540.66
Central National Bank of Oakland...	20,000.00	20,000.00	
	<u>\$185,081.32</u>	<u>\$102,540.66</u>	<u>\$82,540.66</u>
			[55]
Amounts brought forward.....	<u>\$185,081.32</u>	<u>\$102,540.66</u>	<u>\$82,540.66</u>
<b>Payments:</b>			
Cash .....	\$ 75,000.00	\$ 37,500.00	\$37,500.00
New note of Swan and Whitthorne	20,000.00	10,000.00	10,000.00
Total .....	<u>\$ 95,000.00</u>	<u>\$ 47,500.00</u>	<u>\$47,500.00</u>
Profit realized .....	<u>\$ 90,981.32</u>	<u>\$ 55,040.66</u>	<u>\$35,040.66</u>
Total profit through both transactions .....	<u>\$109,582.96</u>	<u>\$ 80,009.13</u>	<u>\$35,040.66</u> <u>\$(5,466.83)</u>

\$27,033.72 of interest due the Central National Bank of Oakland is omitted from the profit computation.

In effecting the settlement the Central National Bank of Oakland released 500 shares of Sherwood Swan and Company, Ltd., and the Bank of America also released 500 shares of Sherwood Swan and Company, Ltd., which had been deposited by the joint debtors. However the Bank of America withheld and assumed title to 1225 shares of Wasserman-Gattman Company, 2000 shares of Swan's and 2071 shares of Hale Brothers Realty Company. To effect this transfer a pledgee's sale was held and the creditor ostensibly bought in these stocks for \$96,073.14, which represented the unpaid balance of the Bank of America loans plus accrued interest. However, at this time stocks in the Wasserman-Gattman Company and Swan's were entirely worthless while the market value of the 2071 shares of



Hale Brothers Realty Company stock was \$34,564.69. Since the transaction was negotiated and agreed to on the basis of a cancellation of the unpaid note balances, over and above the value of the stocks surrendered, the pledge sale at the artificial figure of \$96,073.14 is disregarded; credit is given for a payment by W. R. Whitthorne and yourself equivalent to \$34,564.69, the market value of 2071 shares of Hale Brothers Realty Company stock and the unpaid balance of \$19,501.64 is included as part of the profit realized on the forgiveness of indebtedness.

The benefit from cancellation of your indebtedness in the amount of \$80,009.13 as shown is held to be taxable income in accordance with Article 22(a)-14 of Treasury Regulations 94 and Walker v. Com. 88 Fed. (2) 170. [56]

(b) Your reportable capital gain is revised as follows:

Security	Date Acquired	Cost or Basis	Proceeds	Profit or Loss
(1) One-half interest in 1225 shares Wasser- man-Gattman Com- pany .....	12/ 3/27	None	None	None
(1) One-half interest in 2000 shares Swan's.....	11/10/28	None	None	None
(1) 2071 shares Hale Brothers Realty Company .....	Prior to 12/16/26	\$14,096.01	\$34,546.69	\$20,468.68
One-half interest in 1000 shares Sher- wood Swan and Company, Ltd. ....	Prior to 12/ 2/26	\$42,365.00	\$175,000.00	\$132,635.00

	Taxpayer's share of profit or loss	Per cent reportable under Section 117	Amount Reportable
Wasserman-Gattman Company .....	None	None	None
Swan's .....	None	None	None
Hale Brothers Realty Company.....	\$20,468.68	30%	\$ 6,140.60
Sherwood Swan and Company.....	66,317.50	30%	19,895.25
Total reportable .....			\$26,035.85
As shown in your return.....			3,810.49
Increase .....			\$22,225.36

(1) The proceeds of the stocks transferred to the Bank of America under the debt settlement as outlined in the previous issue are deemed to be the fair market value of such stocks at the time of the transfer. No proceeds are shown for the stock of the Wasserman-Gattman Company and Swan's which were worthless at the time. And since such

[57]

stocks became worthless prior to the taxable year, the stocks had no basis and no loss on the transfer is allowable. The holding that such stocks were worthless in based on the fact that you claimed a deduction due to worthlessness of Wasserman-Gattman Company stock in your 1933 income tax return which was disallowed by the Commissioner on the ground that this stock became worthless in the year 1930. Since the only asset of Swan's, Inc. was holdings of stock in the Wasserman-Gattman Company it too is held to have become worthless in 1930.

(c) On your return a deduction \$32,212.28 was claimed for interest accrued on your separate loan of \$65,000.00 and \$363.24 on your joint loan both due the Bank of America N. T. & S. A. Since it is held that neither loans nor interest were paid but were cancelled upon payment of an amount and transfer of stock values, which did not, in the aggregate, equal the principal of the loans the deduction of \$32,575.52 for interest is denied.

## COMPUTATION OF TAX

Net income adjusted.....		\$120,483.82
Less:		
Personal exemption .....	\$2,500.00	
Credit for dependents.....	400.00	2,900.00
		<hr/>
Balance (surtax net income).....		\$117,583.82
Less:		
. Earned income credit.....		1,176.67
		<hr/>
Net income subject to normal tax.....		\$116,407.15
		<hr/>
Normal tax at 4% on \$116,407.15.....	\$	4,656.29
Surtax on                      \$117,583.82.....		40,198.62
		<hr/>
Correct income tax liability.....	\$	44,854.91
		<hr/>
Income tax assessed:		
Original, account No. 684393—First California		None
Deficiency of income tax.....	\$	44,854.91
Penalty of 5%, Section 291, Revenue Act of 1936	\$	2,242.74
Penalty assessed .....		None
		<hr/>
Penalty due .....	\$	2,242.74
		<hr/>

[Endorsed]: Filed Jan. 16, 1940. [58]

[Title of Board and Cause—Docket No. 101190.]

## FIRST AMENDMENT TO PETITION

The petition of Sherwood Swan filed in the above entitled matter for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IRA:90-

D/LB), dated October 20, 1939, is amended as follows:

I.

Paragraph III of said petition is amended to read:

“The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$41,536.17 and penalty in the amount of \$2,242.74.

Dated: January 17, 1940.

HILLYER BROWN

CHAS. L. BARNARD

Counsel for Petitioner. [59]

State of California,  
County of Alameda—ss.

Sherwood Swan, being duly sworn, says that he is the Petitioner above named; that he has read the foregoing First Amendment to Petition, and is familiar with the statements contained therein, and that the facts stated are true.

SHERWOOD SWAN

Subscribed and sworn to before me this 17th day of January, 1940.

[Seal]

BESSIE E. COTTON,

Notary Public in and for the County of Alameda,  
State of California.

[Endorsed]: Filed Jan. 19, 1940. [60]

[Title of Board and Cause—Docket No. 101190.]

### ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition, as amended, filed by the above-named petitioner admits and denies as follows:

I. Admits the allegations contained in paragraph I of the petition as amended.

II. Admits the allegations contained in paragraph II of the petition as amended.

III. Admits that the tax in controversy is income tax for the calendar year 1936; denies the remaining allegations contained in paragraph III of the petition as amended.

IV(a) to (e), incl. Denies that the Commissioner committed errors as alleged in subparagraphs (a) to (e) of paragraph IV of the petition as amended.

[61]

V-1. For lack of materiality, denies all allegations contained in subparagraph 1 of paragraph V of the petition as amended.

V-2. For lack of materiality, denies all allegations contained in subparagraph 2 of paragraph V of the petition as amended.

V-3. Admits that on December 16, 1936, there was a cancellation and settlement of the indebtedness, referred to in the notice of deficiency attached to the petition as Exhibit A; denies the remaining



allegations contained in subparagraph 3 of paragraph V of the petition as amended.

V-4 and V-5. Denies all allegations contained in subparagraphs 4 and 5 of paragraph V of the petition as amended.

V-6. Admits that the cost to petitioner of 500 shares of Sherwood Swan and Company, Ltd., stock was \$50,000; that at the time of the cancellation and settlement of said indebtedness on December 16, 1936, the fair market value of said shares was considerably in excess of \$50,000; denies the remaining allegations contained in subparagraph 6 of paragraph V of the petition as amended.

V-7. Admits that there was a cancellation and settlement of indebtedness on December 16, 1936, referred to in the notice of deficiency, a copy of which is attached to the petition and marked Exhibit A; denies the remaining allegations contained in subparagraph 7 of paragraph V of the petition as amended. [62]

V-8. Admits that prior to December 21, 1936, petitioner held 500 shares of Sherwood Swan and Company, Ltd., stock; that the cost of said shares to petitioner was \$50,000; that on December 21, 1936, in connection with a tax-free reorganization of Sherwood Swan and Company, Ltd., petitioner exchanged said 500 shares of Sherwood Swan and Company, Ltd., stock for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd., stock; that on November 18, 1936, petitioner entered into a certain contract with Albert

Gersten and Robert E. Hill, doing business under the firm name and style of "Robert N. Miller & Co.," for the sale to said purchasers of certain Class A shares of Sherwood Swan and Company, Ltd., at a price of \$7 per share; denies the remaining allegations contained in subparagraph 8 of paragraph V of the petition as amended.

VI. Admits that petitioner obtained extensions to June 1, 1937, to file his income tax return for the calendar year 1936; denies the remaining allegations set forth in the petition as amended under the heading "In support of assignment of error (e) above."

VII. Denies generally and specifically each and every allegation in the petition as amended not hereinbefore admitted, qualified or denied. [63]

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

J. P. WENCHEL,

Chief Counsel, Bureau of Internal Revenue.  
Of Counsel,

ALVA C. BAIRD,

T. M. MATHER,

HARRY R. HORROW,

Special Attorneys,

Bureau of Internal Revenue.

HRH:sob 2/9/40

[Endorsed]: Filed Feb. 16, 1940. [64]

[Title of Board and Cause—Docket No. 101190.]

## SECOND AMENDMENT TO PETITION

The petition of Sherwood Swan filed in the above entitled manner for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his Notice of Deficiency (Bureau symbols IRA:90-D/LB), dated October 20, 1939, is amended as follows:

### I.

Paragraph III of said Petition is amended to read:

“The taxes in controversy are income taxes for the calendar year 1936 in the amount of \$43,381.44 and penalty in the amount of \$2,242.74.”

### II.

Paragraph IV(c) of said Petition is amended to read:

“(c) Even if the benefit from the cancellation of said indebtedness is applicable to the year 1936 and not the year 1930, and even if cancellation of indebtedness under the circumstances hereinafter alleged constituted taxable income, there was no taxable net income, and consequently the Commissioner erred in finding that the income to Petitioner from said cancellation was in the amount of \$80,009.13.” [65]

## III.

Paragraph IV(d) of said Petition is amended to read:

“(d) The Commissioner erred in finding that during the calendar year 1936 Petitioner sold a one-half interest in 1,000 shares of Sherwood Swan and Company, Ltd. and in finding that the cost or other basis of said 1,000 shares was \$42,365 and in finding that said 1,000 shares were sold for an aggregate sum of \$175,000, or any other sum whatsoever, and in finding that Petitioner’s share of the profit from such sale was \$66,317.50 or any other sum whatsoever. However, Petitioner sold, during said calendar year 1936, 6,250 Class A shares of Sherwood Swan and Company, Ltd. for an aggregate selling price of \$43,750. The cost allocable to said 6,250 Class A shares was \$20,833.33 and taxpayer realized a gain of \$22,916.67 on said sale of Class A shares.”

## IV.

Paragraph IV of said Petition is amended by inserting a new subparagraph at the end thereof to be known as subparagraph (f) to read as follows:

“(f) The Commissioner erred in finding that during the year 1936 the Petitioner received a capital gain of \$20,468.68 of any other sum upon the sale of 2,071 shares of Hale Bros. Realty Company stock and that Petitioner received a taxable profit on such transaction of \$6,140.60 or any other sum.” [66]

V.

Paragraph V-4 of said Petition is amended to read:

“4. That after said cancellation and settlement of indebtedness on December 16, 1936, Petitioner’s assets (other than said 500 shares of Sherwood Swan and Company, Ltd. consisted of:

(i) Said ranch situated in Madera County; and

(ii) An open book account due from Sherwood Swan and Company, Ltd. in the amount of \$9,835.12;

and that the liabilities of Petitioner (other than the liabilities in the aggregate amount of \$195,000 incurred in connection with the payment of said indebtednesses to said banks) consisted of:

((i)) Said indebtedness to Bank of America National Trust and Savings Association in the amount of \$10,000, secured by said ranch in Madera County;

((ii)) An indebtedness to Harry Camp in the amount of \$7,500;

((iii)) A note to David S. Wasserman in the principal amount of \$5,000;

((iv)) Accounts payable to Helen L. Swan in the amount of \$4,788, to Charles Raphael in the amount of \$500, to T. E. Louis in the amount of \$725.10, to R. L. Underhill



in the amount of \$200, to George D. Roberts in the amount of \$500, to McKinstry, Haber & Coombes in the amount of \$300, and to the Moose Club in the amount of \$58.50;

((v)) Joint accounts payable by Petitioner and W. R. Whitthorne to Anglo California National Bank in the amount of \$5,000 and to Orrick, Palmer & Dahlquist in the amount of \$2,000; and

((vi)) Accrued federal income tax and California state income tax liability for the year 1936 in the estimated amount of \$764.35." [67]

## VI.

Paragraph V-5 of said Petition is amended to read:

"5. That consequently the only assets of Petitioner after operation of said cancellation and settlement of indebtedness on December 16, 1936, which had not already been released by said agreement of March 12, 1930, were said ranch in Madera County and said account receivable from Sherwood Swan and Company, Ltd. That on December 16, 1936, the fair market value of said ranch in Madera County was \$6,000; that said ranch continued to be subject to an indebtedness of \$10,000 to Bank of America National Trust and Savings Association secured by a deed of trust thereon; and that the value of the assets of Petitioner after said

cancellation and settlement of indebtedness was \$15,835.12. That the aggregate amount of Petitioner's liabilities on December 16, 1936 (other than said notes in the amount of \$195,000 given in connection with the payment of said cancellation and settlement of indebtedness and including only Petitioner's one-half liability on joint obligations) was \$33,835.95. That in view of the foregoing, Petitioner did not derive any benefit whatsoever by reason or by virtue of the said cancellation and settlement of indebtedness on December 16, 1936."

## VII.

That paragraph V-7 of said Petition is amended to read:

"7. That immediately after the cancellation and [68] settlement of indebtedness on December 16, 1936, referred to in said notice of deficiency, a copy of which is attached hereto and marked 'Exhibit A,' Petitioner's assets consisted of:

(i) 500 shares of Sherwood Swan and Company, Ltd. having a fair market value of not in excess of \$105,000.

(ii) Said ranch in Madera County having a fair market value of \$6,000;

(iii) Accounts receivable owing by Sherwood and Company, Ltd. in the amount of \$9,835.12;

and the liabilities of Petitioner consisted of:

((i)) Joint note of Petitioner and W. R. Whitthorne to The Anglo California National Bank in the principal amount of \$175,000;

((ii)) Joint note of Petitioner and W. R. Whitthorne to the Central Company in the principal amount of \$20,000;

((iii)) Note of Petitioner to Bank of America National Trust and Savings Association having an unpaid principal balance of \$10,000, secured by a mortgage on said ranch in Madera County;

((iv)) Note of Petitioner to D. S. Wasserman in the amount of \$5,000;

((v)) Indebtedness of Petitioner to Harry Camp in the principal amount of \$7,500; [69]

((vi)) Accounts payable of Petitioner to Helen L. Swan in the amount of \$4,788 and to Charles Raphael in the amount of \$500, to T. E. Louis in the amount of \$725.10, to R. L. Underhill in the amount of \$200, to George D. Roberts in the amount of \$500, to McKinstry, Haber & Coombes in the amount of \$300, and to the Moose Club in the amount of \$58.50;

((vii)) Joint account payable of Petitioner and said W. R. Whitthorne to Orrick, Palmer & Dahlquist in the amount of \$2,000; and

((viii)) Joint obligation of Petitioner and said W. R. Whitthorne to Anglo California National Bank in the amount of \$5,000; and

((ix)) Accrued federal and California state income tax of Petitioner for the year 1936 in the approximate amount of \$764.35.

That the aggregate value of said assets of Petitioner was \$120,835.12 and that the aggregate amount of Petitioner's said liabilities (including, in the case of joint obligations, only Petitioner's one-half share thereof) was \$131,335.95, and that the amount by which the value of Petitioner's said liabilities exceeded the amount of his said assests was \$10,500.83.

That by reason of the foregoing, Petitioner did not derive any benefit from said cancellation and settlement of indebtedness on December 16, 1936."

#### VIII.

Paragraph V-8 of said Petition is amended to read:

"8. That during the calendar year 1936 Petitioner did not sell or enter into any contract to sell any shares of [70] Sherwood Swan and Company, Ltd., except as is hereinafter more particularly set forth in this paragraph 8. That prior to December 21, 1936 Petitioner held 500 shares of Sherwood Swan and Company, Ltd. and that the cost of said shares to Petitioner was \$50,000. That on

December 21, 1936, in connection with the tax-free reorganization of Sherwood Swan and Company, Ltd. Petitioner exchanged said 500 shares of Sherwood Swan and Company, Ltd. for 15,000 Class A shares and 22,500 common shares of Sherwood Swan and Company, Ltd. That at the time of said exchange the fair market value of said 15,000 Class A shares was \$105,000 and said 22,500 common shares did not have any fair market value. That the entire cost of said stock, to-wit, \$50,000 is allocable to said 15,000 Class A shares. That on November 18, 1936, Petitioner entered into a contract with Albert Gersten and Robert E. Hill, doing business under the firm name and style of 'Robert N. Miller & Co.' for the sale to said purchasers of 12,500 Class A shares of Sherwood Swan and Company, Ltd. at a price of \$7 per share and a total price of \$87,500. That said purchasers, pursuant to said contract, during the calendar year 1936 purchased from Petitioner 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750, and during the calendar year 1937 purchased 6,250 of said Class A shares and paid therefor to Petitioner a total of \$43,750. That consequently, during the calendar year 1936, Petitioner sold only 6,250 of said Class A shares for said total purchase price of \$43,750. That the cost allocable [71] to said 6,250 Class A shares was not in excess of \$20,833.33 and that the gain



derived from the sale thereof by Petitioner was not in excess of \$22,916.67.”

IX.

Paragraph V of said Petition is amended by adding at the end thereof a new subparagraph to be known as subparagraph (f) to read as follows:

“(f) That on the date of sale of Petitioner’s 2071 shares of Hale Bros. Realty Company stock, to-wit, December 16, 1936, the fair market value of said shares was not in excess of \$8,284; that as a result of said sale Petitioner suffered a loss of \$5,812.01 and a reportable capital net loss of \$1,743.60.

X.

The prayer of said Petition is amended to read:

“Wherefore, Petitioner prays that this Board may hear the proceeding and determine that the deficiency due from the Petitioner for the year 1936 is not in excess of \$1,473.47, and that there is no penalty due from Petitioner for said year.”

ROBERT W. MACDONALD

Counsel for Petitioner

1600 Financial Center Bldg.

Oakland, California [72]

State of California,  
County of Alameda—ss.

Sherwood Swan, being duly sworn, deposes and says that he is the Petitioner above named; that he has read the foregoing Second Amendment to Petition, and is familiar with the statements contained therein, and that the facts stated are true.

SHERWOOD SWAN

Subscribed and sworn to before me this 17th day of October, 1940.

A. MC CREADY,

Notary Public in and for the  
County of Alameda, State  
of California.

(Seal)

[Endorsed]: Filed Oct. 21, 1940. [73]

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[Title of Board and Cause—Docket No. 101190.]

ANSWER TO SECOND AMENDMENT  
TO PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of *Internal*, and for answer to the Second Amendment to Petition filed by the above-named petitioner, admits and denies as follows:

I.

Admits the allegations contained in paragraph I of Second Amendment to Petition except the allegation as to the amount of income taxes in controversy, which is denied.

II.

Denies the allegations contained in paragraph II of the Second Amendment to Petition.

III.

Denies the allegations contained in paragraph III of the Second Amendment to Petition.[74]

IV.

Stricken.

V.

Denies the allegations contained in paragraph V of the Second Amendment to the Petition.

VI.

Denies the allegations contained in paragraph VI of the Second Amendment to the Petition.

VII.

Denies the allegations contained in paragraph VII of the Second Amendment to the petition.

VIII.

Denies the allegations contained in paragraph VIII of the Second Amendment to the Petition.

IX.

Stricken.

## X.

Denies generally and specifically each and every allegation in the Second Amendment to the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and that the petitioner's appeal be denied.

J. P. WENCHEL,

Chief Counsel,

Bureau of Internal Revenue.

Of Counsel:

ALVA C. BAIRD,

Division Counsel.

T. M. MATHER,

Special Attorney,

Bureau of Internal Revenue.

[Endorsed]: Filed Oct. 31, 1940. [75]

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[Title of Board and Cause—Docket Nos. 101189, 101190.]

Promulgated August 13, 1941.

1. When a solvent taxpayer settles a debt for less than the full amount, the saving as a general rule is income.
2. The value of the taxpayer's assets held, upon the evidence, not to establish insolvency.
3. In the settlement of a secured debt for less than its amount, it is not the release of the

pledged property from the lien that constitutes the realization of income, it is the obliteration of the debt itself.

4. The basis for determining gain on the sale of preferred stock received with common in a tax-free exchange held to be an allocable part of the cost of the original shares given up in the exchange, since the evidence shows that both preferred and common had value when received.

5. Under a contract made in 1936 to sell 25,000 shares on prescribed terms, the shares to be delivered as payment was made for each share, 12,500 shares were delivered in 1936 and 12,500 in 1937, within the contract period. Held, the sale of the last 12,500 was in 1937 and the gain therefrom is not within 1936 income.

Robert W. MacDonald, Esq., for the petitioners.

Thomas M. Mather, Esq., for the respondent.

The Commissioner determined deficiencies for 1936 of \$9,902.53 in the income tax of W. R. Whitthorne and a penalty of \$495.12, and of \$44,854.91 in the income tax of Sherwood Swan and a penalty of \$2,242.74. Petitioners assail the determinations (1) of gain in the settlement of debts in 1936; (2) of gain in the sale of shares received in a tax-free exchange; and (3) of a delinquency penalty for failure to file income tax returns in time.



## FINDINGS OF FACT.

Minnie L. Whitthorne and Eva Whitthorne are executrices of the estate of W. W. Whitthorne, who died July 25, 1940. W. R. Whit- [76]thorne and Sherwood Swan (called petitioners), residents of Oakland, California, filed their returns in the first district of California. They were associated in business enterprises for many years. Each had acquired at a cost of \$50,000 one-half of the outstanding 1,000 shares of Sherwood Swan & Co., Ltd. (old company), which operated a market in Oakland.

In March 1930 petitioners were indebted to Harrison S. Robinson on their joint and several promissory note for \$35,000, secured by 1,000 old company shares. They were indebted to David S. Wasserman on their joint purchase money note for \$100,000, secured by 1,000 shares of Wasserman-Gattmann Co., one-half being owned by each. To the Central National Bank of Oakland they owed \$250,000 on their joint and several note secured by 6,000 shares of the Hale Bros. Stores, Inc. To the Bank of America they owed \$100,000 on their joint and several note secured by 2,071 shares of the Hale Bros. Realty Co. To the Central National Bank Swan alone owed an unsecured debt of \$20,000; and to the Bank of America he owed an unsecured debt of \$65,000 and a debt of \$10,000 secured by a mortgage on a ranch.

Pursuant to an agreement between petitioners and the note holders on March 12, 1930, the two banks paid off petitioners' note to Robinson, later being

reimbursed therefor. Petitioners' shares of the old company which were pledged to Robinson were then released, and 500 were pledged with each bank as security for \$100,000 of petitioners' debts to it. The banks agreed not to

\* \* \* look to the securities thus pledged to us in equal amounts for more than the \$100,000 each, \* \* \*.

\* \* \* it was not intended, however, to forgive the indebtedness due by the individuals in excess of this amount.

On December 15, 1936, petitioners on their joint and several demand note borrowed \$175,000 from the Anglo-California National Bank of San Francisco. The Central National Bank was in receivership, and on the same date petitioners made an agreement with the receiver under which they paid him \$75,000 and gave their non-interest-bearing promissory note for \$20,000, payable \$4,000 a year, in full compromise settlement of:

Note signed by—	Face of Note	Balance due
Both .....	\$100,000.00	\$13,080.32
Do.....	15,000.00	15,000.00
Do.....	85,000.00	85,000.00
Do.....	66,000.00	1.00
Swan .....	25,664.67	25,664.67
Both .....	73,369.05	73,369.05
<hr/>		
Total.....	365,033.72	212,115.04

[77]

Accrued interest was due on the notes, and \$5,664.67 and \$21,369.05, respectively, of the face amounts of the last two notes represented unpaid interest on

the original loans. The aggregate original loans represented by the notes were \$185,081.32, of which petitioners were jointly indebted for \$165,081.32 and Swan was individually indebted for \$20,000. The notes were secured by 500 old company shares and by 2,000 shares of Swan's, a corporation, 1,725 shares of Wasserman-Gattmann, and a \$50,000 insurance policy of the life of Swan. The 2,000 shares of Swan's, the 1,725 shares of Wasserman-Gattmann, and the insurance policy were, in a petition for approval of the compromise offer filed with the court in the Central National Bank receivership proceeding, described as worthless. The settlement was approved by the court, and the 500 old company shares were released from pledge.

On December 16, 1936, petitioners were indebted to the Bank of America on notes aggregating \$196,073.14, secured by 500 old company shares, 2,071 shares of the Hale Bros. Realty Co., 2,000 shares of Swan's, a corporation, and 1,725 shares of the Wasserman-Gattmann Co. Of these notes, \$89,066.33 was the aggregate principal amount of joint notes of petitioners and \$65,000 was the principal of a separate note of Swan. On that date a sale of the pledges was held at which petitioners bid in the 500 old company shares for \$100,000 and the Bank of America bid in the remaining securities for \$96,073.14. The 2,071 Hale shares were worth \$34,564.69 and the other shares were worthless. Petitioners paid the bank \$100,000. The 500 old company shares were released from pledge, and, with

the other 500 shares released by the Central National Bank, were placed with the trust department of the Anglo-California Bank.

On December 16, 1936, petitioners' liabilities were as follows:

	Whitthorne	Swan
Joint note to Central Co., \$20,000.....	\$10,000.00	\$10,000.00
Note to Bank of America, secured by mortgage on Swan's ranch.....	.....	10,000.00
Joint notes to Anglo-California Bank, \$175,000 and \$5,000.....	90,000.00	90,000.00
Note due David S. Wasserman.....	.....	5,000.00
Accounts payable .....	1,500.00	15,571.60
Unpaid taxes .....	.....	764.35
Total.....	101,500.00	131,335.95

On the same date each owned 500 old company shares. Whitthorne owned nothing else. Swan owned in addition a claim of \$9,835.12 against the old company and the mortgaged ranch, which had a value of \$6,000. After the settlement of petitioners' indebtedness to the banks, Whitthorne's assets exceeded his liabilities by at least \$35,040.66 and Swan's assets exceeded his liabilities by at least \$80,009.13. [78]

Pursuant to an agreement with the Anglo-California Bank under which the \$175,000 loan had been made to petitioners, the 1,000 old company shares were surrendered by the bank's trust department, and in a tax-free exchange the Sherwood Swan Co. Ltd. (new company), issued therefor



30,000 class A shares of a par value of \$10 each and 45,000 common shares of no par value, representing its entire capital stock. Each petitioner exchanged his 500 old company shares for one-half of the new shares. On November 18, 1936, petitioners and Robert N. Miller & Co. had made a contract contemplating this reorganization. Miller & Co. had agreed to purchase 25,000 class A shares for \$175,000, or at \$7 each; to deposit \$25,000 and securities of a value of \$35,000 with the bank as trustee as security for payment of the price; and to pay \$24,500 to the trustee within 3 days after shares should be available for delivery. Thereupon Miller & Co. became entitled to the delivery of 3,500 shares. The remainder of the purchase price was payable in installments within a 90-day period, the purchaser being entitled upon each payment to delivery of one share for each \$7 paid. It agreed to pay the trustee, in addition to the \$175,000 recited price:

\* \* \* an amount equal to the accrued dividends on each of the 25,000 shares from December 1, 1936, to the date of actual delivery thereof to [it].

In case Miller & Co. should fail to make full payment within the 90-day period, the trustee was directed to apply the \$25,000 and the proceeds of the sale of the securities deposited as collateral to petitioners' note due the bank, and then to deliver to Miller & Co. that number of class A shares neces-



sary to make the total number delivered to it equal to one share for each \$10 paid by it or applied by the trustee on the purchase price under the agreement. During 1936 Miller & Co. deposited the collateral, paid the following installments, and received as payment the following number of shares:

	Payment	Shares
Dec. 23.....	\$49,000.00	7,000
Dec. 26.....	21,000	3,000
Dec. 30.....	17,500	2,500
Total.....	87,500	12,500

Additional installments, completed payment of the purchase price by February 9, 1937; the remaining 12,500 shares were delivered as payments were made, and after final payment the trustee delivered the 2,500 class A and 22,500 common shares remaining with him to each petitioner. There has been no sale of common shares, but in 1937 Whitthorne transferred 4,500 to Swan, who agreed to relieve Whitthorne of liability on their joint \$20,000 note due the Central National Bank. [79]

On December 31, 1936, the new company had assets of a book value of \$858,332.19. It had liabilities of \$370,661.74; a capital stock account of \$390,000, of which \$300,000 was allocated to the 30,000 class A shares and \$90,000 to the 45,000 common shares, and a book surplus of \$97,670.45. Land was carried among the assets at a book value of \$618,674.83. In 1934, 1935, and 1936, the old company's net income and dividends were as follows:

	1934	1935	1936
Net income .....	\$64,025.26	\$65,834.77	\$70,052.26
Dividends .....	12,000.00	32,000.00	11,000.00

The class A shares of the new company are entitled to cumulative preferential annual dividends of 60 cents a share and to a further participating dividend equal to any dividend declared or paid on the common shares for the same period after the common shares shall have received a dividend of 60 cents for that period. Holders of class A shares are entitled to one vote a share, and upon liquidation shall be preferred as to assets to the extent of \$10 a share plus accumulated and unpaid dividends.

Petitioners were granted an extension of time, expiring on June 1, 1937, for filing their income tax returns for 1936. An accountant employed by them completed preparation of the returns on May 29, 1937. The returns, properly signed and sworn to, were delivered to the collector. Swan's return is stamped by the collector as filed on June 2, 1937.

The Commissioner determined that for 1936 Whitthorne received income of \$35,040.66 and Swan income of \$80,009.14 in the settlement with the Central National Bank and the Bank of America. He adopted the profit reported by them of \$66,317.50 on the sale of shares in Sherwood Swan & Co., Ltd., and included 30 percent thereof, or \$19,895.25 in the income of each. He determined penalties for failure to file their income tax returns within the time prescribed by law.

## OPINION.

Sternhagen: 1. The taxpayers were in 1936 jointly indebted to Central Bank for \$165,081.32 and Swan separately owed that bank \$20,000. They compromised this aggregate indebtedness of \$185,081.32<sup>1</sup> for \$75,000 cash and a new joint note of \$20,000, thus relieving themselves of an aggregate of \$90,081.32, of which \$70,081.32 [80] was attributable to the joint note of \$165,081.32 and \$20,000 was attributable to Swan's separate individual note. The Commissioner determined that Whitthorne's income included the released \$35,040.66, one-half the joint note, and Swan's income included the released \$55,040.66, one-half the joint note and all of his separate note.

The taxpayers were jointly indebted to the Bank of America for \$89,066.33 and Swan separately owed that bank \$65,000. This aggregate debt was settled by the payment of \$100,000 cash and the taking by the debtor of the shares of the Hale Bros. Realty Co., Wasserman-Gattmann Co., and Swan's. The shares of the last two corporations were worthless and the shares of the Hale Bros. Realty Co. were recognized as having a value of \$34,564.69. The Commissioner determined that Whitthorne

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<sup>1</sup>The balance due on the face amount of the notes was \$212,115.04, but the Commissioner's determination treats the excess as interest and omits it from the computation. Likewise the excess of the face amount of the Bank of America notes is omitted from the computation.

realized no income in the settlement of this indebtedness and that Swan's income included the \$24,968.47 difference between his share (\$109,533.16) of the aggregate of \$154,066.33 owed and his share (\$50,000) of the amount of cash and the value (\$34,564.69) of the Hale shares paid by Swan in the settlement.

When a taxpayer settles a debt for less than the full amount, the saving, as a general rule, is income. *United States v. Kirby Lumber Co.*, 284 U. S. 1; *B. F. Avery & Sons, Inc.*, 26 B. T. A. 1393; *Highland Farms Corporation*, 42 B. T. A. 1314. The petitioners try to bring themselves within the line of cases holding that income is not realized if the debtor is insolvent before and after the settlement. Swan claims to have had a net insolvency of \$10,500.83 and Whitthorne a net worth of \$3,500. In each instance, their shares in the corporation are treated as worth \$105,000, arrived at by using a value of \$200,000 for the corporation's land. The evidence does not, in our opinion, establish insolvency of either petitioner.

The value of the petitioners' shares is not properly fixed by the value of the land on which the corporation operates the market. Other factors must be considered. In view of all the evidence, the opinions of the witnesses as to the value of the land can not be adopted. The earnings of 1935 were over \$65,000 and of 1936 over \$70,000. The dividends for 1935 were \$32,000 and for 1936 were \$11,000. The new financing was based upon a recognition of



the book value of the market property. The whole-sale price of the class A shares to the dealer was \$7 and to the public \$10. The common shares had commensurate rights which gave them substantial value. It is not necessary to find a definitive value for the corporation's shares, but *is it* clear that they were worth more than enough to show that as assets in the hands of petitioners they preclude a [81] finding of insolvency and do not affect the gain realized in the settlement of their debts.

The petitioners argue a new conception of the doctrine of realization of income in connection with a debt settlement. They say the essence of the realization is not the settlement of the debts alone, but the freeing of assets, and that such freeing of assets occurred in 1930 when the pledge of the shares was limited by the banks to \$100,000. This can not be adopted as the theory of the rule. A solvent taxpayer realizes a gain by a reduction of his debt irrespective of whether the debt is secured by a pledge or mortgage. The freeing of assets which has been regarded in the decisions as a significant fact is not the release of the pledged security from lien, but the effect of enabling the debtor to use all his assets freed from the incubus of the debt. The obliteration of the offsetting liability for debt is what constitutes the gain. If in 1930 the creditor banks had not only agreed to limit the use of the pledged shares to security for \$100,000 of the debt, but had also renounced all claim on the debtor for more than \$100,000, the



forgiveness would have been a gain, not because the lien was limited, but because the excess amount of the debt was discharged without payment. Having been realized in 1930 it would have been taxable then and not later. But it was not until 1936 that the debt was finally settled; so the resulting gain is properly taxable then.

The petitioners also make a point that the measure of the gain, according to their theory, is not the value of the assets freed, but the cost of them to the petitioners, which was \$50,000 to each. The point, however, falls with the theory. Since the release of the pledged shares from the lien is not the occasion of the gain, their particular value or cost is not determinative of the gain. The relevancy of their value when the debt is discharged is only as a factor in considering whether the extent of petitioners' assets demonstrates insolvency; and this, as has been stated, is not true.

The Commissioner's determinations of taxable gain resulting from the settlement of debts to the Central National Bank of Oakland and Bank of America are sustained.

2. The petitioners claim that in the computation of gain resulting from the sale of the new shares the basis has been erroneously distributed between the class A preferred and the common shares. The original 1,000 old company shares cost them \$100,000. The petitioners exchanged their old shares for new and agreed with Miller & Co. to sell 25,000 class A shares to it for \$175,000 on prescribed terms.

They say that in computing the gain from this transaction the basis of \$100,000 must all be assigned to the class A shares because the common shares were worthless. By such a computation [82] the basis of the shares sold would be increased and the gain correspondingly reduced, and the unsold common shares would be left with no basis, and any future sale price would be entirely gain. The Commissioner adopted for the distribution of the basis between the two classes of shares the ratio which petitioners used on their returns, viz., 50.84 percent for the preferred and 49.16 percent for the common. This is, in our opinion, the best the petitioners can demand on the evidence.

The corporation's balance sheet showed a surplus of \$97,670.45 after assigning \$390,000 to capital stock. The assets included the \$618,674.83 book value of the market property. Net income each year was about \$65,000. This was more than enough to have enabled the corporation to pay dividends equal to the first 60 cents on the preferred and the corresponding first 60 cents on the common. Additional dividends were to be equal on the two classes of shares. Other rights of the shareholders were very much alike, except the liquidation preference of the class A. The fact that the common shares were not actually sold is no indication of a lack of market or of value, when the preferred were so promptly sold at \$10 a share on the open market. The basis used by the Commissioner is sustained.

3. The petitioners contend that in 1936 they sold only 12,500 of the class A shares and that their tax may not be measured by a profit from the sale of 25,000 shares. In this we think they are correct. The contract with Miller & Co. was not a sale of the entire 25,000 shares. In fact only 12,500 were delivered in 1936 and, since this was well within the 90-day period, there was no duty of the dealer to take any more in that year. It fulfilled its contract in 1937 by taking the remaining 12,500 and paying for them in that year. It can not be said that the latter were sold in 1936 or that petitioners in that year derived the profit from their sale. They had made a contract to sell, but there is no evidence that this was intended to be an immediate sale. It is error to treat it as such. *Commissioner v. Segall*, 114 Fed. (2d) 706; *Shillinglaw v. Commissioner*, 99 Fed. (2d) 87; *Dahlinger v. Commissioner*, 51 Fed. (2d) 662; certiorari denied, 284 U. S. 673; *Stiver v. Commissioner*, 90 Fed. (2d) 505.

The gain in 1936 should be reduced to that applicable to a sale of 12,500 shares.

4. The Commissioner determined a penalty of 5 percent under section 291, Revenue Act of 1936, for failure of petitioners to file their returns on time. The evidence does not establish that the delay was due to reasonable cause and not to willful neglect, and the penalty is therefore sustained.

Decision will be entered under Rule 50. [83]

United States Board of Tax Appeals  
Washington

Docket No. 101189

ESTATE OF W. R. WHITTHORNE, Deceased,  
MINNIE L. WHITTHORNE and EVA  
WHITTHORNE, Executrices,  
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Subsequent to the Board's report, promulgated August 13, 1941, the respondent filed a computation, which came on for hearing on October 1, 1941. No objections having been filed to the said computation, it is

Ordered and decided that for 1936 there is a deficiency of \$6,894.28 in income tax and a penalty of \$344.71.

Enter:

(Signed) J. M. STERNHAGEN  
Member

Entered Oct. 2, 1941. [84]

United States Board of Tax Appeals  
Washington

Docket No. 101190

SHERWOOD SWAN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent.

DECISION

Subsequent to the Board's report, promulgated August 13, 1941, the respondent filed a computation, which came on for hearing on October 1, 1941. No objections having been filed to the said computation, it is

Ordered and decided that for 1936 there is a deficiency of \$38,687.37 in income tax and a penalty of \$1,934.37.

Enter:

(Signed) J. M. STERNHAGEN  
Member

Entered Oct. 2, 1941. [85]



In the United States Circuit Court of Appeals  
for the Ninth Judicial Circuit

B.T.A. Docket No. 101189

MINNIE L. WHITTHORNE and EVA WHIT-  
THORNE, Executrices, ESTATE OF W. R.  
WHITTHORNE, Deceased,

Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent on Review.

### PETITION FOR REVIEW

To the Honorable Judges of the United States  
Circuit Court of Appeals for the Ninth Judi-  
cial Circuit:

Now come Minnie L. Whitthorne and Eva  
Whitthorne, Executrices of the Estate of W. R.  
Whitthorne, deceased, by R. W. Macdonald, their  
attorney, and respectfully show:

#### I.

Petitioners, Minnie L. Whitthorne and Eva  
Whitthorne, are the duly appointed, qualified and  
acting Executrices of the Estate of W. R. Whit-  
thorne, deceased, hereinafter referred to as the tax-  
payer. Petitioners herein are residents, and W. R.  
Whitthorne, deceased, during his lifetime was a  
resident, of the City of Piedmont, County of Ala-  
meda, State of California, Northern District of

California, and their address is 324 Pacific Avenue, Piedmont, California. [86]

Respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, herein referred to as the Commissioner.

## II.

The taxpayer filed an income tax return for the taxable year 1936 with the Collector of Internal Revenue for the District of Northern California, whose office is located within the Ninth Judicial Circuit, wherein the taxpayer also resides.

Taxpayer, W. R. Whitthorne, died on the 25th day of July, 1940.

## III.

The Collector determined a deficiency in income tax against the taxpayer for the year 1936 in the amount of \$9902.53, together with \$495.12 penalty, and on October 20, 1939, in accordance with the provisions of the applicable statute, sent to the taxpayer by registered mail a notice of said deficiency.

Within ninety (90) days thereafter the taxpayer filed a petition for review from the said notice of deficiency with the United States Board of Tax Appeals, being Docket No. 101189. Said appeal was consolidated for hearing and decision with the appeal of another taxpayer, to-wit, Sherwood Swan, Docket No. 101190, whose appeal was presented simultaneously to the Board. Prior to the trial of said appeal petitioners herein, Minnie L. Whitthorne and Eva Whitthorne, as Executrices of the

Estate of W. R. Whitthorne, [87] deceased, were substituted by order of said Board of Tax Appeals as parties petitioner in the place and stead of W. R. Whitthorne, deceased. Said appeals were tried before said Board of Tax Appeals on oral and documentary evidence and submitted.

On August 13, 1941 the Board of Tax Appeals promulgated its opinion and on the 2nd day of October, 1941, entered its final order and decision in said appeal, wherein and whereby the Board of Tax Appeals ordered and decided that there is a deficiency of \$6,894.28 in income tax and a penalty of \$344.71 against the taxpayer for the said year 1936.

#### IV.

The following is a brief statement of the nature of the controversy:

The Commissioner contends that taxpayer realized taxable income by reason of the cancellation by Bank of America and Central Bank of Oakland of certain indebtedness owed by taxpayer to said banks. Taxpayer contends that he did not thereby realize any taxable income for the following reasons:

1. The pledged stock which was freed in connection with such cancellation transaction had, six years prior thereto, been by agreement of said banks freed from pursuit for all bank indebtedness except \$200,000.00, which sum of \$200,000.00 was paid to said banks in 1936;

2. Taxpayer contends that cancellation of indebtedness [88] does not result in taxable income

unless, prior to such cancellation transaction, taxpayer was insolvent and after such transaction was solvent, and further, that in determining solvency or insolvency, assets freed from the burden of debt by the cancellation transaction cannot be valued at any amount in excess of their cost basis to taxpayer; applying this rule, taxpayer was insolvent after the cancellation transaction.

3. Taxpayer contends that cancellation of indebtedness does not result in taxable income unless, prior to such cancellation transaction, taxpayer was insolvent and after such transaction was solvent, and further, that in determining solvency or insolvency, assets freed from the burden of debt by the cancellation transaction cannot be valued at any amount in excess of the net fair market value of the assets so released; applying this rule, taxpayer was insolvent after the cancellation transaction.

4. Taxpayer received Class "A" stock and Common stock of Sherwood Swan & Company in a non-taxable exchange and in the year 1936 sold the Class "A" stock. Taxpayer contends that all of the cost basis of such stock should be allocated to the Class "A" stock and none to the Common stock since the latter had no fair market value.

The Commissioner contends that taxpayer is subject to a 5% penalty for a one (1) day delay in filing his Return for the taxable year. Taxpayer contends that he should be relieved from such penalty.

Wherefore, petitioner prays that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript be prepared in accordance with law and with the rules of said Court, and that appropriate action be taken by said Court.

R. W. MACDONALD

Attorney for Petitioner

State of California,  
County of Alameda—ss.

R. W. Macdonald, being first duly sworn, deposes and says: That he is the attorney for the petitioner in the above entitled Petition for Review; that he makes this verification for and on behalf of said petitioner; that he has read the foregoing Petition for Review and knows the contents thereof and that the same is true of his own knowledge except as to those matters which are therein stated upon information or belief and as to such matters that he believes the same to be true; that this verification is made by affiant as such attorney for the reason that the facts set forth in said Petition for Review are within the information of affiant.

R. W. MACDONALD

Subscribed and sworn to before me this 22nd day of December, 1941.

(Seal)

A. McCREADY

Notary Public in and for the County of Alameda,  
State of California. [90]



In the United States Circuit Court of Appeals  
for the Ninth Judicial Circuit

[Title of Cause—Docket No. 101189.]

### AFFIDAVIT OF MAILING

Wilma S. Gray, being duly sworn, deposes and says: That she is and at all times herein mentioned was a citizen of the United States, having a business address at 1600 Financial Center Building, Oakland, California, in the County of Alameda, where the mailing herein referred to took place; that she is over the age of eighteen years, not a party to the within entitled cause *of* interested in the event thereof; that on the 23rd day of December, 1941 she enclosed in an envelope a copy of the Petition for Review in the above entitled action, sealed said envelope and addressed the same as follows, to-wit:

“Clerk  
Board of Tax Appeals  
Washington, D. C.”

That on said day affiant deposited said envelope so addressed and with the postage thereon fully prepaid in the United States Post Office in the City of Oakland, County of Alameda, State of California; that there is and at all times herein mentioned there was regular communication by United States mail between said City of Oakland and said City of Washington, D. C.

WILMA S. GRAY

Subscribed and sworn to before me this 23rd day  
of December, 1941.

(Seal)

A. McCREADY

Notary Public in and for the County of Alameda,  
State of California.

[Endorsed]: Filed Dec. 26, 1941. [91]

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In the United States Circuit Court of Appeals  
for the Ninth Judicial Circuit

Docket No. 101190

SHERWOOD SWAN,

Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent on Review

### PETITION FOR REVIEW

To the Honorable Judges of the United States Cir-  
cuit Court of Appeals for the Ninth Judicial  
Circuit:

Now comes Sherwood Swan, by R. W. Macdonald,  
his attorney, and respectfully shows:

#### I.

Petitioner, herein referred to as the taxpayer, is  
a resident of the City of Oakland, County of Ala-  
meda, State of California, Northern District of  
California, and his address is S. W. corner Tenth  
and Washington Streets, Oakland, California.

Respondent is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, herein referred to as the Commissioner.

## II.

The taxpayer filed an income tax return for the [92] taxable year 1936 with the Collector of Internal Revenue for the District of Northern California, whose office is located within the Ninth Judicial Circuit, wherein the taxpayer also resides.

## III.

The Collector determined a deficiency in income tax against the taxpayer for the year 1936 in the amount of \$44,854.91, together with \$2242.74 penalty, and on October 20, 1939, in accordance with the provisions of the applicable statute, sent to the taxpayer by registered mail a notice of said deficiency.

Within ninety (90) days thereafter the taxpayer filed a petition for review from the said notice of deficiency with the United States Board of Tax Appeals, being Docket No. 101190. Said appeal was consolidated for hearing and decision with the appeal of another taxpayer, to-wit, the Estate of W. R. Whitthorne, deceased, Docket No. 101189, whose appeal was presented simultaneously to the Board. Said appeals were tried before said Board of Tax Appeals on oral and documentary evidence and submitted.

On August 13, 1941, the Board of Tax Appeals promulgated its opinion and on the 2nd day of

October, 1941, entered its final order and decision in said appeal, wherein and whereby the Board of Tax Appeals ordered and decided that there is a deficiency of \$38,687.38 in income tax and a penalty of \$1934.37 against the taxpayer for said year 1936. [93]

#### IV.

The following is a brief statement of the nature of the controversy.

The Commissioner contends that taxpayer realized taxable income by reason of the cancellation by Bank of America and Central Bank of Oakland of certain indebtedness owed by taxpayer to said banks. Taxpayer contends that he did not thereby realize any taxable income for the following reasons:

1. The pledged stock which was freed in connection with such cancellation transaction had, six years prior thereto, been by agreement of said banks freed from pursuit for all bank indebtedness except \$200,000.00, which sum of \$200,000.00 was paid to said banks in 1936;

2. Taxpayer contends that cancellation of indebtedness does not result in taxable income unless, prior to such cancellation transaction, taxpayer was insolvent and after such transaction was solvent, and further, that in determining solvency or insolvency, assets freed from the burden of debt by the cancellation transaction cannot be valued at any amount in excess of their cost basis to taxpayer; applying this rule, taxpayer was insolvent after the cancellation transaction.

3. Taxpayer contends that cancellation of indebtedness does not result in taxable income unless, prior to such cancellation transaction, taxpayer was insolvent and after such transaction was solvent, and further, that in determining [94] solvency or insolvency, assets freed from the burden of debt by the cancellation transaction cannot be valued at any amount in excess of the net fair market value of the assets so released; applying this rule, taxpayer was insolvent after the cancellation transaction.

4. Taxpayer received Class "A" stock and Common stock of Sherwood Swan & Company in a non-taxable exchange and in the year 1936 sold the Class "A" stock. Taxpayer contends that all of the cost basis of such stock should be allocated to the Class "A" stock and none to the Common stock since the latter had no fair market value.

The Commissioner contends that taxpayer is subject to a 5% penalty for a one (1) day delay in filing his Return for the taxable year. Taxpayer contends that he should be relieved from such penalty.

Wherefore, petitioner prays that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that a transcript be prepared in accordance with law and with the rules of said Court, and that appropriate action be taken by said Court.

R. W. MACDONALD

Attorney for Petitioner [95]



State of California,  
County of Alameda—ss.

R. W. Macdonald, being first duly sworn, deposes and says: That he is the attorney for the petitioner in the above entitled Petition for Review; that he makes this verification for and on behalf of said petitioner; that he has read the foregoing Petition for Review and knows the contents thereof and that the same is true of his own knowledge except as to those matters which are therein stated upon information or belief and as to such matters that he believes the same to be true; that this verification is made by affiant as such attorney for the reason that the facts set forth in said Petition for Review are within the information of affiant.

R. W. MACDONALD

Subscribed and sworn to before me this 22nd day of December, 1941.

(Seal)

A. McCREADY

Notary Public in and for the County of Alameda,  
State of California. [96]

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In the United States Circuit Court of Appeals  
for the Ninth Judicial Circuit

[Title of Cause—Docket No. 101190.]

AFFIDAVIT OF MAILING

Wilma S. Gray, being duly sworn, deposes and says: That she is and at all times herein mentioned

was a citizen of the United States, having a business address at 1600 Financial Center Building, Oakland, California, in the County of Alameda, where the mailing herein referred to took place; that she is over the age of eighteen years, not a party to the within entitled cause or interested in the event thereof; that on the 23rd day of December, 1941 she enclosed in an envelope a copy of the Petition for Review in the above entitled action, sealed said envelope and addressed the same as follows, to-wit:

“Clerk  
Board of Tax Appeals  
Washington, D. C.”

That on said day affiant deposited said envelope so addressed and with the postage thereon fully prepaid in the United States Post Office in the City of Oakland, County of Alameda, State of California; that there is and at all times herein mentioned there was regular communication by United States mail between said City of Oakland and said City of Washington, D. C.

WILMA S. GRAY

Subscribed and sworn to before me this 23rd day of December, 1941.

(Seal)

A. McCREADY

Notary Public in and for the County of Alameda,  
State of California.

[Endorsed]: Filed Dec. 26, 1941. [97]

OFFICIAL REPORT OF PROCEEDINGS [98]

TESTIMONY OF HARRISON S. ROBINSON

Direct Examination

Q. (By Mr. Macdonald) Your name is Harrison S. Robinson? A. Yes.

Q. Your occupation? A. Attorney at law.

Q. And your office is where?

A. Oakland, California.

Q. You were an attorney at law in March of 1930? A. Yes.

Q. Did you at that time have any professional and business relations with Petitioners herein, Sherwood Swan and W. R. Whitthorne? A. Yes.

Q. What professional relations?

A. I was their attorney.

Q. And had been for some years? A. Yes.

Q. And retained for some years thereafter?

A. Yes.

Q. Did you also have business relations with them? A. Yes. [119]

Q. Will you state what those business relations were?

A. They owed me the sum of \$35,000 secured by a pledge of the stock of the Tenth Street Market.

Q. The Tenth Street——

A. (Interposing) That is not the exact name. You will have to refresh my memory on the exact name of the corporation. There were two corporations, and I can't remember which the stock was in.

(Testimony of Harrison S. Robinson.)

Q. The name of the corporation was "Sherwood Swan and Company, Ltd."?

A. That is correct.

Q. Were these gentlemen in March, 1930, also largely indebted to the Bank of America, Oakland Branch, and to Central National Bank of Oakland?

A. They were.

Q. Was an arrangement entered into between Messrs. Whitthorne and Swan and those banks and you in March, 1930, with respect to the refunding of your indebtedness and with respect to the treatment which would be accorded by the bank to the securities of the Sherwood Swan and Company which would be pledged to the banks?

A. May I refer to a memorandum which I prepared from my office records to refresh my memory?

The Member: If your memory is no good without it.

The Witness: Well, I can't say that it is "no good [120] without it."

The Member: Perhaps you had better answer the questions as best you can.

The Witness: Will you read that question, please?

(The question referred to was read by the reporter as above recorded.)

The Witness: There were certain understandings and agreements.

Q. (By Mr. Macdonald) Was that in writing or oral?

A. At the time it was made it was oral, and it is my recollection that letters or a letter was subse-

(Testimony of Harrison S. Robinson.)

quently written by one of the banks expressing the terms of the arrangement, part of them.

Q. Well, we will speak of those letters later, sir. Can you fix the date of that oral agreement?

A. Well, I can only fix the date of it by having a look at my diary kept during that year and entries made day by day, and my inspection of the diary shows that I attended conferences with the banks on—I think it was March 11 and March 12.

Q. 1930?           A. Pardon?

Q. 1930?

A. 1930. And it was on one of those two occasions that the final arrangement was expressed and made. [121]

Q. Where were those conferences?

A. At the Board room, the room at which the Board of Directors of the Central Bank of Oakland customarily met at the banking office, in Oakland, California.

Q. Who was present?

A. I remember being present Mr. Joseph Carlston, President of the Central Bank of Oakland——

Q. (Interposing) May I interrupt you, Mr. Robinson? At that time it was the Central National Bank.

A. Central National Bank; thank you.

(Continuing) ——Mr. Oscar L. Cox, who was then Vice-President of the Bank of America and the Senior Officer of that bank in Alameda County, Mr. Swan, — Mr. Sherwood Swan — I think Mr.



(Testimony of Harrison S. Robinson.)

Wainwright,—but of that I haven't a completely independent memory—and myself.

Q. Who was Mr. Wainwright?

A. Mr. Wainwright was a Vice-President of the Central National Bank. And the gentleman who was in the course of these discussions was Mr. Carlston, to my positive recollection.

Q. What was said at this conference?

A. It was stated by the bankers—and by “the bankers” I mean Mr. Carlston and Mr. Cox—that they would by some procedure take over the indebtedness which I held against the stock just heretofore referred to. I was to receive [122] thereby the \$35,000 plus any accrued and unpaid interest up to the time of the consummation of the transaction. Each bank agreed, or stated that they would, if you prefer that, look to the stock which I then held as security for the repayment of \$100,000 each, plus one-half of the \$35,000 plus whatever interest they paid which was then owing to me, and that so far as these two banks were concerned, the stock of the Swan Company would not be looked to by them or resorted to by them for more than \$100,000 each plus one-half of the \$35,000 with interest as aforesaid thereon.

Q. What happened with respect to the agreed payment of \$35,000 and interest to you?

A. That was paid.

Q. When?

A. I couldn't give you the exact date without—it was very shortly after that. There was a sale

(Testimony of Harrison S. Robinson.)

very shortly after that, I think, as soon as the notice could be given for the holding of a pledgee sale.

Q. All I wanted was: That was immediately after this transaction you received your money?

A. Within a comparatively few days.

Q. Do you know whether or not subsequently these banks did release to Mr. Swan the stock in —Mr. Swan and Mr. Whitthorne—the stock in Sherwood and Swan Company which [123] they thus received?

A. What do you mean by “released to them?”

Q. Delivered over to them, freed from pledge.

A. Well, my memory is that that was done in 1936.

Q. Do you know what payment Mr. Swan and Mr. Whitthorne made at that time to secure the release of the stock from pledge?

A. I couldn't tell you, no.

Mr. MacDonald: Cross examine.

#### Cross Examination

Q. (By Mr. Mather) Mr. Robinson, what was the year in which Sherwood Swan & Whitthorne were indebted to you?

A. Well, they had been indebted to me for many years. That was a loan which had been going on for a long while.

Q. Well, in 1930 were they indebted to you to the extent of \$35,000?      A. Principal, yes.

Q. Was that indebtedness secured by Sherwood Swan's stock?

(Testimony of Harrison S. Robinson.)

A. There were two companies and it was secured by the stock of the parent company, as I recollect it.

Q. Yes. And that stock was also up as collateral for loans which Sherwood Swan and Whitthorne owed to the two banks; was it not?

A. I can't remember that independently whether it was or not. [124]

Q. You do not know whether it was?

A. My—I may have known something about it at the time, but I have no present memory of that.

Q. I see. Well, in what year were you paid your \$35,000?      A. In 1930.

Q. In 1930?      A. Oh, yes.

Q. Yes.

A. But, you see, that \$35,000 had been owing to me for a number of years.

Q. Yes.

A. The exact duration of that loan I could easily ascertain for you.

Q. Well, that is not important. I want to know the year it was satisfied. I was under the impression that shortly after that, that your testimony was they turned the stock over, or that the banks released the stock from pledge?

A. Oh, no; not that I know of.

Mr. Macdonald: He testified that that was in 1936.

The Witness: No, my memory is that the banks held on to their security. In 1930 they paid me off

(Testimony of Harrison S. Robinson.)

the \$35,000, and they were to have as security the stock which we have been talking about for the \$100,000 apiece, and for half of the \$35,000 plus a small amount of interest.

Q. (By Mr. Mather) Now, at that time was the Central [125] Bank of Oakland in receivership?

A. No, sir.

Q. It was after that?

A. Well, it must have been a long while. I can remember distinctly that Mr. Carlston was active and in complete executive charge of the bank.

Q. Of Oakland?

A. The Central Bank of Oakland—the Central National Bank, I should say.

Mr. Mather: I think that is all.

Mr. Macdonald: Thank you.

The Member: Step aside.

(Witness excused.)

Mr. Macdonald: Mr. Wainwright.

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### JAMES A. WAINWRIGHT

a witness on behalf of Petitioners, was duly sworn and testified as follows:

#### Direct Examination

Q. (By Mr. Macdonald) Your name, please?

A. James A. Wainwright.

Q. Your occupation, Mr. Wainwright?

(Testimony of James A. Wainwright.)

A. Vice-President, Central Bank.

Q. What was your occupation in March of 1930?

A. I was employed by the Central National Bank handling some of their past due accounts.

[126]

Q. Among such past due accounts were there obligations due from the Petitioners herein, Mr. Sherwood Swan and Mr. W. R. Whitthorne?

A. Yes, sir.

Q. Who had charge of the matter of handling those accounts?

A. Mr. Carlston, President of the Central National Bank, and myself.

Q. Was there an agreement entered into—correction——

Do you of your own knowledge know whether there was any other banking institution to which those gentlemen were similarly indebted?

A. Yes, sir.

Q. What was it?                      A. Bank of America.

Q. Was there in the month of March, 1930, an agreement entered into between Messrs. Swan and Whitthorne and those two banks with respect to the handling of certain collateral securing their indebtedness to the banks and to the terms under which such collateral was to be released?                      A. Yes, sir.

Q. Was that agreement oral or in writing?

A. In writing.

Q. By "writing" you mean it was evidenced by



(Testimony of James A. Wainwright.)

certain letters exchanged between officers of the banks? A. That is right. [127]

Q. Prior to those letters was the agreement reached at conference?

A. Numerous conferences, yes.

Q. Where were such conferences held?

A. Some were held in the Central Bank—the Central National Bank in Oakland, and I had several meetings in San Francisco in the offices of the Bank of America with Oscar Cox, the Vice-President of that bank.

Q. Speaking with respect to the meetings held in your bank, can you fix the date with any approximation?

A. I can only fix it by copies of the correspondence which I obtained from the Receiver of the Central National Bank, I believe I gave you copies of those letters which I can identify.

Q. Well, we will take the letters later.

But if you can, fix it to the best of your memory at this time. If you cannot, why, say so, and we will go on.

A. I wouldn't want to fix the date without looking at the correspondence, as it is so long ago.

Q. But the year you can fix?

A. About 1930 I would say.

Q. Who was present at the conferences held in that year in your bank? [128]

A. Well, there was numerous conferences. I remember distinctly conferences with Mr. Sherwood

(Testimony of James A. Wainwright.)

Swan and Mr. Carlston and Mr. Oscar Cox, that is, in the Central National Bank in Oakland. In the Bank of America in San Francisco I was the only representing the Central National Bank.

Q. Well, I am speaking with reference to the conference held in your bank. You mentioned Mr. Swan, Mr. Cox, Mr. Carlston and yourself. Was Mr. Harrison Robinson also there?

A. I have a recollection that I was at that meeting that I heard Mr. Robinson testify to. I wouldn't want to say definitely.

Q. What is your memory of what was said at that meeting?

Mr. Mather: If your Honor please, I will object to that, the witness having testified that this agreement was reduced to writing by letters, writing what the agreement was.

I submit that that would be the best evidence, if there was such writing.

The Member: Is there any virtue in the oral recollection?

Mr. Macdonald: In this, sir: I think these writings, which were days, and sometimes months afterwards, were simply reminders to the various parties that they had on March 12, 1930, or whenever it was, entered into an agreement. I doubt if these papers constitute an agreement. [129] But it is Mr. Robinson writing to Mr. Swan, Mr. Cox writing to Mr. Wainwright saying, "We did so agree."

The Member: I will overrule the objection.

(Testimony of James A. Wainwright.)

The Witness: We had numerous conferences and it was agreed between the Bank of America, Central National Bank and Mr. Swan that we would release the stock, the Central National Bank had as security and the Bank of America would agree to release the stock they had as security, that is, the stock of the Sherwood Swan Company, I believe it was, the holding company, on the payment of \$100,000 to each bank. And we agreed that we would not pursue that stock or the market that was being operated by Sherwood Swan and Company of anything being in excess of \$100,000 for each bank.

Mr. Macdonald: I have submitted, your Honor, to Mr. Mather and now desire to introduce in evidence marked exhibit next in order, a copy of a letter dated March 14, 1930, addressed to Mr. J. F. Carlston, President, Central National Bank, signed by Oscar L. Cox, Vice-President, Bank of America.

That will be Petitioner's No. 1?

The Member: It will be received.

Mr. Mather: No objection.

The Clerk: Exhibit 1. [130]

(The letter so offered and received was marked Petitioner's Exhibit No. 1 and made a part of this record.)

Mr. MacDonald: Copy of a letter dated March 15, 1930, signed by J. F. Carlston, President, Central National Bank, addressed to Mr. Oscar Cox, Vice-President, Bank of America, in reply to Exhibit No. 1.

(Testimony of James A. Wainwright.)

Cross Examination

Q. (By Mr. Mather) At the time, Mr. Wainwright, that these conferences were taking place in 1930, were Mr. Swan and Mr. Whitthorne indebted to your bank and the other bank in excess of \$100,000? A. Yes, sir.

Q. I show you Petitioner's Exhibit 1 and ask you if that is your recollection of the agreement that was entered into in 1930 with respect to this indebtedness?

A. (Examining document) Yes, that is my understanding.

Q. I show you Petitioner's Exhibit 2 and ask you if it is your understanding that there was no intention on the part of the banks to release Sherwood Swan and Whitthorne for any indebtedness that they owed the banks in 1930?

A. Do you mean indebtedness in excess of \$100,000; if that had been paid?

Mr. Mather: No. Will you read the question?

(The question referred to was read by the reporter as above recorded.) [133]

The Witness: There was no intention to forgive any of the indebtedness.

The Member: What was that?

The Witness: No intention to forgive any of the indebtedness.

Q. (By Mr. Mather) And your bank from 1930 on until 1936 made repeated demands upon Sher-

(Testimony of James A. Wainwright.)

wood Swan and Whitthorne for payment of their indebtedness to your bank, did they not?

A. Well, all I could testify is from 1930 to 1933 because the Central National Bank was in receivership in March, 1933. And thereafter the affairs of the Central National Bank were handled by, first, a conservator and then a receiver.

Q. Until 1933 did you make any demands upon them for the payment of their indebtedness?

A. I am quite sure that we made the ordinary demands we make on every debtor by way of notices, when the notes would come due, and so on.

The Member: Am I to understand that they did make demands upon these debtors?

The Witness: I would say "Yes."

The Member: All right.

Q. (By Mr. Mather) Were there conferences between your bank and the Bank of America relative to the foreclosure of the properties of Sherwood Swan and Whitthorne? [134]

A. Foreclosure of properties?

Q. Yes.

A. I didn't know there was any property other than the securities we are talking of here.

The Member: Well, now, read the question.

(The question referred to was read by the reporter as above recorded.)

The Witness: I don't recall that we discussed foreclosure.



(Testimony of James A. Wainwright.)

Q. (By Mr. Mather) Were there discussions with respect to instituting suit for the payment of the indebtedness?

A. I don't believe it was ever discussed. I don't recall the discussion of suit. I do recall numerous discussions urging Mr. Swan to endeavor to finance the market in order to pay on our indebtedness.

Mr. Mather: That is all.

Mr. MacDonald: That is all, Mr. Wainwright.

The Member: Let me ask you one question:

These loans which were outstanding, how did they originate? These indebtednesses, I mean; how did they originate?

The Witness: Your Honor, I couldn't say as to the origin because they were—as I recall it, the entire debt was due when I came with the bank, and I presume it was the ordinary advances made to Sherwood Swan—— [135]

The Member: (Interposing) You don't know?

The Witness: I don't know. I couldn't say.

The Member: All you know is that from 1930 on there were indebtednesses in these amounts?

The Witness: That is right.

The Member: By these individuals to the banks; is that right?

The Witness: That is right.

The Member: Very well.

Mr. MacDonald: Just one question, Mr. Wainwright.

(Testimony of James A. Wainwright.)

Redirect Examination

Q. (By Mr. MacDonald) On cross examination you testified that there was no intent in the 1930 agreement to release indebtedness, but there was an agreement to release security upon agreed terms?

A. That is right.

Mr. MacDonald: That is all.

(Witness excused.)

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Mr. MacDonald: If your Honor please, Mr. Oscar L. Cox, whose name has been used herein, who at that time was a Vice-President of the Bank of America here, is now the President of the Union Trust Company of Cleveland, Ohio.

May it be stipulated that if Mr. Cox were here, he would testify to the same effect that Mr. Wainwright has?

Mr. Mather: No. But it may be stipulated that he [136] would testify to the substance of the letters he wrote.

Now, that was my understanding, as I recall, with you; that I would stipulate if Mr. Cox were called as a witness, he would testify to the same information that is contained in his letters.

The Member: Which are what exhibits?

Mr. MacDonald: There are two or three letters from him here, sir.

Mr. Mather: It might save stipulation with respect to each one of his letters, if that is agreeable.

Mr. MacDonald: Well, Mr. Mather, I do not want to push your stipulation if you did not understand it as I did at our conference. But I wanted Mr. Cox' testimony stipulated with respect to the oral agreement of March 1930; that that agreement was entered into in the office of Central Bank between the parties.

Mr. Mather: Well, I will stipulate that his understanding with respect to the oral agreement is as set forth in his letter of such and such a date which is Exhibit, Petitioner's Exhibit—(Pause).

Mr. MacDonald: All right. I am satisfied with that statement.

The Member: Now, identify the exhibits, please.

Mr. MacDonald: 1, 3, 5, 6 and 7, all signed by Mr. Cox. [137]

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### SHERWOOD SWAN

a witness on behalf of the Petitioners, was sworn and testified as follows:

#### Direct Examination

Q. (By Mr. MacDonald) Your name is Sherwood Swan? A. Yes. [138]

Q. You are one of the Petitioners herein?

(Testimony of Sherwood Swan.)

A. Yes, sir.

Q. You are one of the officers of Sherwood Swan & Company, Ltd.?

A. Yes.

Q. The President?

A. Yes.

Q. And have been such since its inception?

A. Yes.

Q. When?

A. 1924 the Corporation was organized.

Q. You have been acquainted with Mr. Whitthorne until the date of his death from what date?

A. 1909, in the fall.

Q. During the interval, you were engaged in business associations of various kinds with him?

A. Right.

Q. In March of 1930 you and Mr. Whitthorne were each heavily indebted to the Central National Bank of Oakland and to the Bank of America?

A. Yes, sir.

Q. Those were in amounts far in excess of \$100,000 each to each of the banks?

A. Yes.

Q. Those loans at that time—— [139]

The Member: (Interposing) Mr. MacDonald, I want to be sure about this word "each".

There are two debtors, and apparently several creditors. I am not sure what the word "each" means as it has been used here several times.

Mr. MacDonald: Thank you, sir. I think that would clarify matters.

Q. (By Mr. MacDonald) Can you from memory

(Testimony of Sherwood Swan.)

give an itemization of your indebtedness to each of those banks?

If not, I can supply it after the recess. The reason I hesitate, sir, is I know I have it buried in my files. Some of the notes were joint notes signed by each gentleman, some of it secured by the assets of one and some of it the other.

The Member: I am only interested to avoid having the record contain any ambiguity.

Mr. MacDonald: Yes, I didn't realize this is ambiguous until you called my attention to it.

Mr. Mather: Mr. MacDonald, is there any dispute with respect to the indebtedness of each of these petitioners, as set forth in the deficiency letter from which the appeal was taken?

Mr. MacDonald: The deficiency letter is a correct statement of the indebtedness of the respective petitioners to the respective banks.

The Member: Well, is that agreed? [140]

Mr. Mather: Yes, your Honor.

The Member: Very well.

Mr. MacDonald: Thank you for that.

Mr. Mather: That is stipulated.

Q. (By Mr. MacDonald) Prior to the agreement of March, 1930, your indebtedness and Mr. Whitthorne's to those banks was secured by what securities?

A. At the Bank of America there was stock of Hale Bros. Realty Company owned by me.



(Testimony of Sherwood Swan.)

Q. 2071 shares?

A. Right. Offhand that is the only security that I recall prior to that—prior to the March, 1930, agreement.

Q. Well, then, may I remind you there was also pledged to the Bank of America stocks of Swan's and of Wasserman-Gattman Company; is that correct, sir?

A. That was not prior to the agreement of March. They all came along approximately at the same time, Mr. MacDonald.

Q. Thank you. Prior to March, 1930, were you and Mr. Whitthorne in debt to Mr. Harrison Robinson?

A. To the extent of \$35,000 and some accrued interest.

Q. Evidenced by—(pause)

A. A joint and several note, as I recall.

Q. And secured by—(pause)

A. A thousand shares of the capital stock of Sherwood Swan and Company, Ltd., which was all of the capital stock of [141] Sherwood Swan and Company, Ltd.

Q. That stock was at that time owned—(pause)

A. Jointly by Whitthorne and myself.

Q. Mr. Swan, I remind you that the word "jointly" has a legal meaning.

What do you mean by the use of the word "jointly"?

(Testimony of Sherwood Swan.)

A. My recollection was that it hadn't been divided, but our ownership was half and half.

Q. Was there an agreement entered into in March, 1930, between you and Mr. Whitthorne, Mr. Robinson and those two banks with respect to the refinancing of Mr. Robinson's loan and with respect to the handling by the banks of the stock of Sherwood Swan and Company, to be pledged to the banks? A. There was.

Q. When was that agreement entered into?

A. Well, approximately around the middle of March. The exact date isn't in my mind.

The Member: May I interrupt long enough to clear up something that I have been in doubt about since the beginning of the trial?

Mr. MacDonald: Yes, sir.

The Member: Prior to 1930 I understand that you were indebted in one amount, namely, \$35,000, to Robinson, and that you were also indebted in a separate amount to one or more of the banks; is that correct? [142]

The Witness: That is correct, your Honor.

The Member: And to Robinson was pledged the 1000 outstanding shares of the Sherwood Swan company?

The Witness: "And Company, Ltd.," your Honor. That is correct.

The Member: Yes. And that was the entire outstanding stock of that corporation?

(Testimony of Sherwood Swan.)

The Witness: That is correct.

The Member: So that to the bank creditors there was not at that time any pledge of the shares of Sherwood Swan and Company, Ltd.?

The Witness: That is correct.

The Member: Is that correct?

The Witness: That is correct, your Honor.

Mr. MacDonald: Interrupting my examination of the witness for a moment, sir, and to proceed along that line, and, as suggested by Mr. Mather, I am reading from the Agent's deficiency letter herein:

"The indebtedness to the Bank of America was a \$65,000 indebtedness of Mr. Swan alone and \$89,066.33 indebtedness signed by both Whitthorne and Swan, a total liability of \$154,066.33, apportioned by the Agent, \$109,533.16 from Swan and \$44,533.17 from Whitthorne and indebtedness to the Central National Bank of from Swan alone \$20,000, Whitthorne and Swan together \$165,081.32, a total [143] indebtedness to that bank of \$185,081.32, apportioned \$102,540.66 to Swan, \$82,540.66 to Whitthorne."

The Member: Is that agreed, Mr. Mather?

Mr. Mather: That is agreed, your Honor.

The Member: My question of this witness was only inspired by the fact that the witness, Robinson, left it in a fog as to the pledge. He said that there were securities pledged to the bank and to him, and I could not tell which securities he was

(Testimony of Sherwood Swan.)

referring to and how that pledge operated at the time in 1930.

Proceed.

Mr. MacDonald: My last question?

(The question referred to was read by the reporter as above recorded.)

Q. (By Mr. MacDonald) Was it orally or in writing? A. That was an oral agreement.

Q. Where was it entered into?

A. In the Directors' room of the Central National Bank.

Q. Who was present?

A. There was Mr. Carlston, Mr. Cox, Mr. Robinson, Mr. Wainwright and myself.

Q. What was said?

A. Discussion was had in regard to the matter of the banks coming into possession of the entire 1000 shares of the capital stock of Sherwood Swan and Company by the banks [144] paying Mr. Robinson the amount of his indebtedness, plus the accrued interest then unpaid.

The Member: You do not mean the amount of his indebtedness; do you?

The Witness: No, the amount of our indebtedness, Whitthorne's and mine, the indebtedness of \$35,000 plus the interest then unpaid; this \$35,000 plus the unpaid interest due Robinson, being repaid subsequently by ourselves plus the sum of \$100,000 to each of the two banks, the stock would be released to us beyond pursuit.

(Testimony of Sherwood Swan.)

The Member: What stock would be released to you?

The Witness: The stock of Sherwood Swan and Company, Ltd., your Honor.

Q. (By Mr. MacDonald) 1000 shares?

A. 1000 shares.

Q. One-half held in pledge by each bank?

A. Yes, sir.

Q. Was that stock ever released to you?

A. Yes.

Q. From pledge?

A. That stock was released from pledge in December of 1936 to the Trust Department of the Anglo Bank, and subsequently in the recasting of the stock of Sherwood Swan and Company we came into possession of the unsold balance in the recasted corporation, recasted capital of the same corpora- [145] tion.

Q. What payment did you cause to be made to the Bank of America at the time of such release of stock from its pledge?

A. \$100,000 to the Bank of America.

Q. What payment did you cause to be made to the receiver of the Central National Bank at the time of such release of its 500 shares of pledged stock?

A. \$75,000 in cash and a joint and several note, Whitthorne and myself, of \$25,000.

Q. A total of—(pause)



(Testimony of Sherwood Swan.)

A. \$175,000 to the two banks, of cash, and the \$20,000 note.

Q. I hand you your petition herein and, calling attention to page 4, paragraph Roman numeral five, Arabic one, and ask you whether the six items set forth therein represented all your assets in March, 1930?

A. (Examining document) Yes, sir.

Q. I call your attention to the same paragraph and ask you whether the seven items of liabilities set forth therein, ending on the top of the next page, represented your personal and joint and several liabilities at that time?

A. (Examining document) Yes, sir.

Q. Were you at this time familiar—by “this time” I mean March, 1930—with Mr. Whitthorne’s business affairs and with his assets and liabilities?

[146]

A. I feel that I was.

Q. I hand you herewith Mr. Whitthorne’s petition herein, calling your attention to page 4, paragraph V, Roman, Arabic 1 thereof, and ask you whether or not the items I to V thereof represented all of Mr. Whitthorne’s assets on that date?

A. (Examining document) I believe that to be a correct statement of Mr. Whitthorne’s assets as of that date.

Q. I call your attention to the same paragraph the four items marked ((i)) to ((iv)), of liabilities, and ask you whether those represented all of

(Testimony of Sherwood Swan.)

Mr. Whitthorne's liabilities, joint and personal and joint and several upon that date?

A. I believe it a correct statement of the liabilities of Mr. Whitthorne's as of that date.

The Member: We will take a five-minute recess.

(Whereupon, a brief recess was taken after which proceedings were resumed as follows:)

Q. (By Mr. MacDonald) Mr. Swan, you had just identified and testified to the truthfulness of a statement of your assets and your liabilities in March, 1930, Mr. Whitthorne's assets and his liabilities in 1930 as shown by the paragraphs in your respective pleadings setting forth such assets and liabilities.

That statement in the pleading of liabilities shows [147] the securities pledged for each respective liability. My question before was not broad enough to cover the securities and I am now asking you:

Were those statements a correct statement of the securities pledged to each of the banks for the respective liabilities? A. They were.

Q. I hand you a description of real property and ask you if that is a correct description of the real property of Sherwood Swan and Company in December, 1936?

A. (Examining document) No, there is an error in this description, Mr. MacDonald.

Q. Thank you, sir. Will you make the correction?

A. Yes, sir. In the fifth line from the bottom

(Testimony of Sherwood Swan.)

“... thence easterly parallel with said line of Tenth Street, one hundred . . . feet to said Westerly line of Washington Street . . .”

That should be one hundred fifty feet.

That is 100, 175—(pause)

Q. Your correction is proper.

A. Let me see. That is correct. That makes 300 feet.

Mr. MacDonald: I would ask that this be marked exhibit next in order. I want to show it to your expert witnesses who testify as to the value of the property.

The Member: You are offering it? [148]

Mr. MacDonald: Yes, sir.

The Member: Any objection?

Mr. Mather: No objection.

The Clerk: Exhibit 9.

(The said property description so offered and received in evidence was marked Petitioner's Exhibit No. 9 and is made a part of this record.)

Mr. MacDonald: If your Honor please, I would ask permission to temporarily withdraw this witness for this reason:

I have present in the courtroom two real estate men who will testify as to values. Mr. Swan will be here all the rest of the day for testimony, and I do not want to hold them beyond the noon hour, if I can avoid it.

(Testimony of Sherwood Swan.)

Mr. Mather says he has no objection to my withdrawing Mr. Swan for this purpose.

The Member: Very well.

(Witness temporarily excused.)

Mr. MacDonald: Mr. Kittrelle.

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R. W. KITTRELLE

a witness called on behalf of Petitioners, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. MacDonald) Your name?

A. R. W. Kittrelle. [149]

The Clerk: What was that?

The Witness: R. W. Kittrelle, K-i-t-t-r-e-l-l-e.

Q. (By Mr. MacDonald) And your place of business, Mr. Kittrelle? A. Oakland.

Q. And your profession?

A. I am a real estate broker, appraiser.

Q. How long have you been engaged in that business? A. Since 1906.

Q. Have you made a specialty of the appraising branch of that business? A. Yes, sir.

Q. For what institutions, if any, are you now engaged as appraiser?

A. Well, I am the appraiser of the Central Bank of Oakland, First Federal Savings, the Alameda County Federal Savings, San Francisco Fed-

(Testimony of R. W. Kittrelle.)

eral Savings, Connecticut Mutual Life Insurance Company, Alameda Investment, and do a general appraisal business besides.

Q. What court experience have you had in the appraisal field?

A. Well, I have appeared both for private parties and for the State, City, County and the schools in condemnation proceedings.

Q. In what county? [150]

A. Alameda County.

Q. That is the county that Oakland is situated in?

A. Yes, sir.

The Member: Is this market in Oakland?

Mr. MacDonald: Yes, sir.

The Witness: Tenth and Washington.

The Member: Oh, I thought it was in San Francisco.

Mr. MacDonald: I wish we had made that more clear in the start. I am sorry.

Q. (By Mr. MacDonald) I hand you Petitioner's Exhibit No. 9, which is a description of the real property of Sherwood Swan & Company as of December, 1936, and ask you if you were in December, 1936, familiar with that property?

A. (Examining document) Yes, sir.

Q. Did you then in December, 1936, know the fair market value of that real estate?

A. I consider that I did. I made an appraisal on it, Mr. MacDonald in November—on November 25, '36.



(Testimony of R. W. Kittrelle.)

Q. For whom?

A. For the Central Bank on the land and improvements at that time.

Q. What, in your opinion, was the fair market value of that land, exclusive of improvements, on December 16, 1936?

Mr. Mather: That is objected to as calling for a conclusion of the witness. [151]

The Member: The objection is overruled.

The Witness: My estimate of value was \$195,000 for the land.

Mr. Macdonald: Cross examine.

#### Cross Examination

Q. (By Mr. Mather) Do you know what improvements were on the property in 1936?

A. Yes, sir.

Q. What did the improvements consist of?

A. A market. There was—oh, the exact date of the change of a piece on Washington I am not positive because I am talking from memory—but a market covered practically all of the property.

Mr. Mather: That is all.

Mr. Macdonald: That is all.

The Member: Tell me what was the occasion of your appraisal in November, 1936

The Witness: Mr. Swan came to the bank for a loan, I think. They did not discuss that with me, except that I know he was trying to refinance, and

(Testimony of R. W. Kittrelle.)

two or three times I was called in and discussed it.

If my memory is correct, I believe Mr. Swan went out to a life insurance company at the time, and I believe those people also communicated with me.

The Member: That is all. [152]

(Witness excused.)

Mr. Macdonald: Mr. Field.

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### EDWARD B. FIELD

a witness on behalf of Petitioners, was duly sworn and testified as follows:

#### Direct Examination

Q. (By Mr. Macdonald) Your name?

A. Edward B. Field, F-i-e-l-d.

Q. And your place of business?

A. 369 15th Street, Oakland.

Q. And your occupation?

A. Real Estate Broker and appraiser.

Q. How long have you been so engaged?

A. Twenty years.

Q. All of that time in the city of Oakland?

A. Yes, sir.

Q. Can you state to the Court what experience you have had in the matter of appraisals?

A. Over 20 years I have appraised for the State of California, the County of Alameda, the City of

(Testimony of Edward B. Field.)

Oakland, innumerable corporations, individuals, loan companies.

Q. Have you had court experience in that field?

A. Many, many times; yes, sir.

Q. One or two recent illustrations?

A. I was appointed by the Superior Court of Alameda County [153] two weeks ago in the condemnation by the Housing Authority in West Oakland, the property condemned by the Housing Authority and so-called slum clearance in West Oakland.

Q. Were you in 1936 familiar with the real estate—December, 1936—then owned by Sherwood Swan and Company, Ltd., sometimes known as the “Tenth Street Market,” situate at the corner of Tenth and Washington Streets? A. Yes, sir.

Q. I hand you Petitioner’s Exhibit No. 9, stated to be a description of that property.

Were you in December, 1936, familiar with the fair market value of that land, not including improvements? A. Yes, sir.

Q. What, in your opinion, was such fair market value as of December 16, 1936?

Mr. Mather: That is objected to as calling for a conclusion of the witness, no proper foundation having been laid for the introduction of this testimony.

The Member: Overruled.

The Witness: May I finish the description?

Mr. Macdonald: Yes.

(Testimony of Edward B. Field.)

The Member: The question, as I understand it, is limited to the land.

Mr. Macdonald: Yes, sir.

The Witness: Yes, sir. [154]

Q. (By Mr. Macdonald) What was such fair market value? A. \$200,000.

Mr. Macdonald: Cross examine.

#### Cross Examination

Q. (By Mr. Mather) Are you familiar with the improvements on the property at that time?

A. Yes, sir.

Mr. Mather: That is all.

(Witness excused.)

Mr. Macdonald: Mr. Swan.

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#### SHERWOOD SWAN

a witness on behalf of Petitioners, previously duly sworn, testified further as follows:

#### Direct Examination

(Resumed)

Q. (By Mr. Macdonald) In your testimony with respect to the steps taken on December 16, 1936, to release from pledge the stock in Sherwood Swan and Company, you stated that you paid to the Receiver for the Central National Bank \$75,000 cash and a \$20,000 note? A. That is correct.

Q. That note was signed by Messrs. Whitthorne and Swan? A. Yes.

(Testimony of Sherwood Swan.)

Q. What interest did it bear?

A. No interest.

Q. How was it payable? [155]

A. It was payable \$4,000 per year for a period of five years.

Q. Have payments been made to date?

A. Three \$4,000 payments have been made.

Q. By whom? A. By myself.

Q. Those annual payments were due on what date?

A. I think in each case, December 16th, the anniversary of the making of the notes.

Mr. Macdonald: What is the next number?

The Clerk: Ten.

Q. (By Mr. Macdonald) Will you state to the Court the reclassification of the stock of Sherwood Swan and Company, Limited, which took place on December 16, 1936?

A. It was—the 1000 common shares of Sherwood Swan and Company, Ltd., was recast into 30,000 shares of class A stock and 45,000 shares of common stock.

Q. A portion of such class A preferred stock was marked by you and Mr. Whitthorne to a broker?

A. Yes, sir.

Q. On what date?

A. December—my recollection of the date of the contract was December 16, 1936.

Q. How many shares?

A. 25,000 shares was the amount actually sold.



(Testimony of Sherwood Swan.)

I haven't [156] refreshed my mind recently as to the amount that was contracted to be sold.

Q. I hand you a statement of assets and liabilities, and ask if that is a correct statement of your assets and liabilities as of December, 1936, immediately prior to the marketing of such a preferred stock? [157]

A. I would say that it is a correct statement of my assets and liabilities as of that time.

Mr. Macdonald: I ask that this be Petitioner's Exhibit 10.

Mr. Mather: Objected to as not the best evidence.

The Member: Overruled.

The Clerk: Exhibit 10.

(The said financial statement so offered and received in evidence was marked Petitioners' Exhibit No. 10 and is made a part of this record.)

Q. (By Mr. Macdonald) I hand you a statement reading "W. R. Whitthorne statement of assets and liabilities as at December 16, 1930."

You have previously testified to your years of association with Mr. Whitthorne. Were you familiar with his assets and liabilities as of December 16, 1930?

A. I believe I was familiar with his—— [158]

Q. (Interposing) '36.

A. (Continuing) ——assets and liabilities.

(Testimony of Sherwood Swan.)

I was going to make that correction, Mr. Macdonald. This statement is as of December 16, 1936. I feel that I am familiar with his affairs as of that date.

Q. Is that statement a true statement of his assets and liabilities as of that date?

Mr. Mather: That is objected to as calling for a conclusion of the witness, not the best evidence.

The Member: I will sustain that objection until it appears how the statement was made, who made it, how it was ascertained. Otherwise, the witness may testify from his recollection without refreshing it.

Mr. Macdonald: Well, let's try that. Let's take this away from you, sir (obtaining document from the witness).

Q. (By Mr. Macdonald) What investments, if any, did W. R. Witthorne have on December 16, 1936?

A. He had a half interest in Sherwood Swan and Company, Ltd.

Q. How many shares was that?

A. In the original corporation he had 500 shares and in the recast—that is, 500 shares of common. In the recast corporation he had 22500 shares of common and 2500 shares of A. [159]

Q. Your 2500 shares of A is spoke of as after the sale to the public of a portion of the A?

A. That is correct.

(Testimony of Sherwood Swan.)

Q. How many shares of A did he have prior to the sale to the public?

A. The 30,000 shares of A was divided, half Whitthorne and half myself. That would mean 15,000 shares of A for Mr. Whitthorne and 22,500 shares of common for Mr. Whitthorne.

Q. What other assets did Mr. Whitthorne have at that date? A. He had nothing else.

Q. What were his liabilities as of that date?

A. He had a half interest of the liability on this \$20,000 note given to the Central *company*; he had one-half of the liability due the Trust department of the Anglo, \$2,500. He had half of the——

The Member: (Interposing) Half of the \$2,500?

The Witness: No, half of five thousand, your Honor, in the sum of \$2,500. He had half of the indebtedness due *Roberts*, his half being \$250; owed half of the indebtedness in addition to the \$5,000 due the Trust Department, the \$175,000 that we borrowed on a joint and several note, and for which all of the original stock of Sherwood Swan and Company and the recast stock of Sherwood Swan and Company was collateral.

Q. That was owing to what bank? [160]

A. The Anglo.

Q. Did he owe any attorneys' fees, to your knowledge?

A. He owed one-half of the attorneys' fees to Orrick, Dahlquist, Palmer—I forget the other.

(Testimony of Sherwood Swan.)

Q. Orrick, Palmer & Dahlquist.

A. His share was \$1,000.

Q. Were those all of his liabilities?

A. As nearly as I can recall them at this time without refreshing my memory.

The Member: Are you quite sure, however, that you have stated all of his assets?

The Witness: Yes, sir.

The Member: But there may possibly have been other liabilities?

The Witness: There might possibly have been; might possibly have been others. His affairs and mine were so intertwined, your Honor, that at that particular time it was virtually that his were the same as mine.

Q. (By Mr. Macdonald) Were there any sales in the year 1936 of the common stock of Sherwood Swan and Company, Ltd., the old stock, prior to the recasting thereof? A. No, there were not.

Q. Was there ever any sale after the recasting of the stock of the B or common stock of Sherwood Swan and Company, Ltd. [161]

A. There was one transaction between Whitthorne and myself.

Q. What was that transaction and when?

A. I don't recall the exact date, Mr. Macdonald?

Q. What year?

A. My recollection is it was in 1936. The number of shares was 4,500.

Q. 4,500 shares of the common stock, class B common stock of Sherwood Swan and Company, Ltd., and that was sold by whom to whom?

(Testimony of Sherwood Swan.)

A. That was sold by Mr. Whitthorne to me.

Q. What consideration did you pay him for that stock?

A. One—one—Mr. Whitthorne and I had that joint and several note with the Central, and I agreed to pay——

Q. (Interposing) To him notes, to leave it that way.

The note that you refer to was the \$20,000 non-interest-bearing note which you and Mr. Whitthorne on December 16, 1936, signed to the receiver of the Central National Bank; is that correct?

A. That is correct. And I assumed—and I agreed to assume Mr. Whitthorne's half of that in consideration of his transferring to me this 4,500 shares of the common stock.

Q. How did you reach that figure as the appropriate consideration for these 500 shares? [162]

A. It is just one of these things that happens between old friends.

Q. How many shares was it?

A. 4,500 shares. I say it is just one of these things that happen between old friends.

Mr. Whitthorne was a man of rather mature years.

The Member: Well, do you mean he was older than you?

The Witness: Oh, yes; much older.

The Member: You look rather mature yourself.



(Testimony of Sherwood Swan.)

Mr. Macdonald: I think we are all mature, Mr. Swan; I hope.

Q. (By Mr. Macdonald) How old was Mr. Whitthorne?

A. Mr. Whitthorne passed away this year at the age of 77. I just passed 53, so the difference between our ages was 24 years. We had been associated, as I have just explained, for many years, and because of his senior—very senior years and just one of those nice things that friends work out between themselves, we discussed the matter back and forth, and it was agreed that I would assume the other half of this \$20,000 note, joint and several note.

Q. All the payments that have been made on that note have been made by you personally?

A. That is correct.

The Member: Now, specifically there. Am I to [163] understand that that means that you agreed to the liability of \$10,000, or, to relieve him of the liability of \$10,000 on the \$20,000 note and he was to transfer to you 4,500 shares of the class B common stock; is that right?

The Witness: That is correct, your Honor.

The Member: Now, did you have any negotiation which brought about the fixing of the 4,500 shares, or the consideration?

The Witness: No, we never—we never discussed value as such.

The Member: You did not dicker about this?

(Testimony of Sherwood Swan.)

The Witness: Oh, we talked about it for some little time, but we never went back to the books and discussed value, sir. I wanted the 4,500 shares of stock in order to give me what would be substantial control of the company, and Mr. Whitthorne wanted me to have it because of the fact that in the ordinary course of things I would remain much longer than he, and we just agreed on the assumption of this liability more as—because it was that figure than that that was the value of it. We didn't discuss value. We never thought of it that way.

The Member: Well, I can understand about the \$10,000 of the note, from what you say. But I am trying to find a reason for 4,500 shares, rather than some other figure. [164]

The Witness: Oh, I can explain that very simply.

That gave me 60 per cent holding and gave him 40 per cent holding.

The Member: Without the 4,500 shares, what were your respective proportions?

The Witness: Fifty-fifty.

Q. (By Mr. Macdonald) Have there ever been any other sales of that class B stock? A. No.

Q. Any offers or bids? A. No.

Q. Have you ever offered it for sale?

A. No.

Q. Or had Mr. Whitthorne or his estate?

A. Not—Mr. Whitthorne never did during his lifetime, that he ever informed me in regard to, and I know nothing about it subsequently, except that

(Testimony of Sherwood Swan.)

I have acted as adviser to the family, and they have never mentioned it.

Q. Has any bid ever been received from anyone else offering to buy any of that B stock?

A. Not so far as I know.

The Member: When did Whitthorne die? It is not in the record.

The Witness: July 25th of this year.

The Member: Oh, just a few months ago? [165]

Mr. Macdonald: Your Honor, it has been indicated that the settlement with the Central National Bank was made through the Receiver of that bank, which had been appointed in 1933 and was acting in 1936. [166]

I have obtained from the Receiver—which Mr. Mather has examined—copies of Receiver's petition to the Federal Court asking for leave to make this settlement, and a copy of the Federal Court's order authorizing settlement.

I ask that be received as exhibit next in order.

Mr. Mather: No objection.

The Clerk: Do you want these one exhibit?

Mr. Macdonald: No, two.

The Clerk: The petition will be Exhibit 13 and the order Exhibit 14.

(The said petition so offered and received in evidence was marked Petitioner's Exhibit No. 13 and is made a part of this record.)

(The said order so offered and received in evidence was marked Petitioner's Exhibit No. 14 and is made a part of this record.)

(Testimony of Sherwood Swan.)

Mr. Macdonald: That was the Central Bank's mechanism of closing. The Bank of America adopted as its mechanism for closing a pledgee sale which was conducted on behalf of the Bank of America on December 16, 1936, by Mr. Matt Wahrhaftig, who was the attorney for the Bank of America in Oakland at that time.

He has signed his certificate of pledgee sale of the proceedings whereby he sold securities at pledgee's sale. [167]

I offer this as Petitioner's next in order.

Mr. Mather: No objection.

The Clerk: Exhibit 15.

(The said certificate so offered and received in evidence was marked Petitioner's Exhibit No. 15 and is made a part of this record.) [168]

Q. Now, Petitioner's Exhibit 10, Mr. Swan, is a statement of assets and liabilities of yourself.

Who is R. L. Underhill?

A. R. L. Underhill is an appraiser, calls himself an "appraisal engineer", lives on Tamalpais Way in Berkeley.

Q. And under the heading of "liabilities" is \$200.00.

What does that represent?

A. That is the unpaid balance on a bill rendered by Mr. Underhill to myself. The original amount of the bill was \$700.00.

Q. What was it for?

(Testimony of Sherwood Swan.)

A. It has to do with an appraisal made by Mr. Underhill, I judge along in 1934. I don't recall the exact date.

Q. For what purpose? [169]

A. Appraisal of the market—the property known as the “Tenth Street Market property.”

Q. Do you know what he appraised it at?

Mr. Macdonald: Just a minute. I object to that as hearsay.

The Member: Well, the job was done for this witness. I will overrule the objection.

The question is: “Do you know what he appraised it at?”

The Witness: Not the exact figure. I would be glad to state a general recollection.

Q. (By Mr. Mather) All right, what is your general recollection?

Mr. Macdonald: May I renew the objection and make this point, sir:

If **Mr. Underhill** were here, I would have an opportunity to cross examine. For his appraisal to be introduced in any direct manner like this would prevent me from breaking it down, if I could, by cross examination.

The Member: I will overrule the objection.

Mr. Macdonald: Exception.

The Witness: My general recollection is around \$600,000.

Q. (By Mr. Mather) Now, you spoke, Mr. Swan, of “Recasting this stock.”



(Testimony of Sherwood Swan.)

What do you mean by "recast"? [170]

A. I am not a technical man, but I will explain to you what I mean.

The original stock of the corporation, Sherwood Swan and Company, Ltd., was for 1000 shares of \$100 each par value, \$100,000 total.

After what I have referred to as the "recasting" there was 30,000 shares of A stock of a par value of \$10, and 45,000 shares of common stock of no par value.

Q. What became of the thousand shares that had been outstanding prior to this time?

A. That was turned in to the corporation.

Q. And cancelled? A. Yes, sir.

Q. So that the entire capital stock as the result of this transaction consisted of two classes of stock, 30,000 class A and 45,000 common?

A. That is correct.

Q. Now at the time of this transaction, or, recasting, as you call it, was there a prospectus issued by the brokers in connection with the sale of that 25,000 shares to the public? A. There was.

Mr. Mather: May I have this marked for identification?

The Clerk: Respondent's A marked for identification. [171]

(The prospectus referred to was thereupon marked Respondent's Exhibit A for identification.)

(Testimony of Sherwood Swan.)

Q. (By Mr. Mather) I hand you, Mr. Swan, a document marked for identification "Respondent's Exhibit A" and ask you to state, if you can, what that is?

A. (Examining document) That is the prospectus that was issued at the time this stock was offered to the public.

Q. That was along in the latter part of 1936?

A. That is correct.

Q. Is that your signature (indicating)?

A. Yes, sir.

Q. Is the information contained therein true, to the best of your information?

A. It is true to the best of my information at that time, sir.

Q. Yes. Now, referring to this prospectus, and particularly to the paragraph relative to your properties, I am wondering if you can refresh your recollection from that and tell me what value Mr. Underhill placed on these properties?

A. As of the date of this appraisal, which is a second appraisal of the property, the one that we discussed—the one you asked me about a moment ago—was a different appraisal. This appraisal made as of December 14, 1936, is for the sum of \$710—

[172]

Mr. Macdonald: (Interposing) Just a minute. I object to the evidence of appraisal coming in in this indirect way as hearsay; and any way except

(Testimony of Sherwood Swan.)

by the testimony of the appraiser present in court subject to cross examination.

The Member: Overruled.

Mr. Macdonald: Exception.

The Witness: \$710,000, Mr. Mather.

Q. (By Mr. Mather) Was Mr. Underhill employed by you to make an appraisal of the property for the purpose of this prospectus?

A. As President of the corporation I employed Mr. Underhill to make this appraisal.

Mr. Mather: Yes. Mark this for identification Respondent's Exhibit B.

The Clerk: Marked for identification "Respondent's Exhibit B".

(The income tax return referred to was thereupon marked Respondent's Exhibit No. B for identification.)

Q. (By Mr. Mather) I hand you a document, Mr. Swan, marked for identification "Respondent's Exhibit B" and ask you to state, if you can, what that document is?

A. (Examining document) This is my personal income tax statement for the calendar year 1936.

Q. Did you give that document some consideration at the [173] time it was prepared?

A. Oh, yes.

Q. Was it prepared from the best available information you had at the time that it was prepared?

A. I would say "yes."

(Testimony of Sherwood Swan.)

Q. Did you believe, Mr. Swan, at the time you prepared that return that the correct proportionment between the class A stock of Sherwood Swan and the common stock was 61.67 for the class A and 38.33 for the common?

A. (Examining document) These statements were prepared in consultation between our accountants and our attorneys at that time, and it was our opinion that that was a fair division.

I personally had no opinion in regard to it. It was one of those things that was discussed back and forth, and I acquiesced in the discussions.

Q. Sherwood Swan and Company had been paying substantial dividends; had it not?

A. Yes, sir.

Q. And continued to pay after '36; did it not?

A. Yes.

Q. Substantial dividends? A. Yes, sir.

The Member: We will suspend until 2:00 o'clock.

(Whereupon, at 12:30 p.m. a recess was taken until [174] 2:00 o'clock p. m. of the same day.)

[175]

(Testimony of Sherwood Swan.)

by the testimony of the appraiser present in court subject to cross examination.

The Member: Overruled.

Mr. Macdonald: Exception.

The Witness: \$710,000, Mr. Mather.

Q. (By Mr. Mather) Was Mr. Underhill employed by you to make an appraisal of the property for the purpose of this prospectus?

A. As President of the corporation I employed Mr. Underhill to make this appraisal.

Mr. Mather: Yes. Mark this for identification Respondent's Exhibit B.

The Clerk: Marked for identification "Respondent's Exhibit B".

(The income tax return referred to was thereupon marked Respondent's Exhibit No. B for identification.)

Q. (By Mr. Mather) I hand you a document, Mr. Swan, marked for identification "Respondent's Exhibit B" and ask you to state, if you can, what that document is?

A. (Examining document) This is my personal income tax statement for the calendar year 1936.

Q. Did you give that document some consideration at the [173] time it was prepared?

A. Oh, yes.

Q. Was it prepared from the best available information you had at the time that it was prepared?

A. I would say "yes."



(Testimony of Sherwood Swan.)

Q. Did you believe, Mr. Swan, at the time you prepared that return that the correct proportionment between the class A stock of Sherwood Swan and the common stock was 61.67 for the class A and 38.33 for the common?

A. (Examining document) These statements were prepared in consultation between our accountants and our attorneys at that time, and it was our opinion that that was a fair division.

I personally had no opinion in regard to it. It was one of those things that was discussed back and forth, and I acquiesced in the discussions.

Q. Sherwood Swan and Company had been paying substantial dividends; had it not?

A. Yes, sir.

Q. And continued to pay after '36; did it not?

A. Yes.

Q. Substantial dividends? A. Yes, sir.

The Member: We will suspend until 2:00 o'clock.

(Whereupon, at 12:30 p. m. a recess was taken until [174] 2:00 o'clock p. m. of the same day.)

[175]

(Testimony of Sherwood Swan.)

Afternoon Session

2:00 o'clock p.m.

### SHERWOOD SWAN

a witness on behalf of the petitioner, previously duly sworn, testified further as follows:

#### Cross Examination

(Resumed)

Q. (By Mr. Mather) Mr. Swan, Respondent's Exhibit A for identification correctly sets forth the dividends that were paid by Sherwood Swan and Company from 1930 on; does it not?

A. Through 1936.

Q. Yes.           A. Yes, sir.

Q. And it also correctly sets forth the earnings of the Company for the same period?

A. Yes, sir.

Q. Was that Respondent's Exhibit A prepared for use in connection with the marketing of the 25,000 class A shares of the company?

A. This particular form set-up was so prepared, but some of these previous statements were the audited statements already made prior to the preparation of this form.

Q. Was that document made available to the public in connection with marketing the 25,000 class A shares?           A. This document? [176]

Q. Yes.           A. Yes, sir.

(Testimony of Sherwood Swan.)

Q. And the 25,000 class A shares were sold to the public, were they not, for \$10 a share?

A. Plus accrued dividends, yes, sir.

Mr. MacDonald: Just a moment. If you know, of your own knowledge. Did you sell them?

The Witness: No. That was provided for in the agreement.

Mr. Mather: Will you read the question, please?

(The question referred to was read by the reporter as above recorded.)

Mr. MacDonald: I object to the question as indefinite, as not indicating who sold them to the public, whether by this taxpayers or some one else.

The Member: Sustained.

Q. (By Mr. Mather) Do you know whether the 25,000 shares were sold to the public at \$10 a share?

A. Not of my own knowledge, no, sir.

Q. You do know that the 25,000 shares were sold within a period of approximately 90 days; do you not, Mr. Swan?

A. I would say so, to the best of my knowledge and belief.

Q. You do know that the 25,000 shares were sold to the public, do you not? [177]

A. I would say "yes."

Q. Now, did Mr. Whitthorne own his own home, Mr. Swan?           A. No.

Q. He rented that?

A. No. When the home was purchased originally

(Testimony of Sherwood Swan.)

it was purchased in Mrs. Whitthorne's name. It still is not clear.

The Member: You mean the title is in doubt?

The Witness: No. It is not fully paid for, your Honor.

The Member: Oh. That is what you mean by "clear", is it, clear from encumbrances?

The Witness: Yes, sir.

The Member: I see.

Q. (By Mr. Mather) Who was paying for it?

A. Who is paying for it now?

Q. Who was during 1936?

A. At that particular time Mr. Whitthorne was not living in the home. It was rented, and my knowledge of Mr. Whitthorne's affairs doesn't include who paid for it. Mr. Whitthorne had an income at that time of \$35 a week.

Q. You do not know who was paying for the home?

A. At that time, no, I do not.

Q. Was there not, Mr. Swan, always another note for \$10,000 upon which you and Mr. Whitthorne were jointly obligated, which was assumed by you in addition to the \$20,000 note that you testified to? [178]

A. No, not that I know of.

Q. I hand you, Mr. Swan, a document and ask you to state, if you can, what that is?

A. (Examining document) This is the agreement to run between Miller and Company or Rob-

(Testimony of Sherwood Swan.)

ert N. Miller and Company and Whitthorne and myself for the purchase by Miller and Company of 25,000 shares of the A stock of Sherwood Swan and Company, Ltd.

Q. There is an exhibit, I believe, attached to that document which refers to \$25,000 collateral which was put up by you and Mr. Whitthorne to secure the carrying out of the agreement.

Was that money put up by you and Mr. Whitthorne?

A. It was borrowed by Mr. Whitthorne and me and put up by Mr. Whitthorne and me.

Q. To whom?

A. Mr. Whitthorne and me.

Q. Who was it put up with; the bank?

A. That was put up with the Anglo.

Q. The Anglo California National Bank.

A. Yes, sir.

Q. Now, was that money, \$25,000, to be returned to you when the \$175,000 note was returned?

A. Yes, sir.

Q. And was it so returned to you by the bank?

A. Yes, sir. [179]

Q. I show you——

The Member: (Interposing) Now, before you get away from that paper that he has now, do you not at least want it marked?

Mr. Mather: Well, I suspect that the Petitioner will probably want to put that in.

The Member: Whatever it is, the testimony of



(Testimony of Sherwood Swan.)

the witness should in the transcript be related to a paper which is in the record and designated as something.

Mr. MacDonald: I certainly want it in evidence, and if it will help Mr. Mather, it may be introduced as Petitioner's next in order right now.

Mr. Mather: No objection.

The Member: Very well.

The Clerk: Exhibit 16.

(The said agreement so offered and received in evidence was marked Petitioner's Exhibit No. 16 and is made a part of this record.)

Q. (By Mr. Mather) I hand you Petitioner's Exhibit 10, Mr. Swan.

Do you know who prepared that exhibit?

A. (Examining document) No, I don't know who prepared it.

Q. Do you know from what information it was prepared?

A. It was prepared from information that has been accumulated from time to time over the period of the last several years. [180]

Q. Is the information contained in your books of account?

A. The last part of that question I didn't catch.

The Member: Read it.

(The question referred to was read by the reporter as above recorded.)

(Testimony of Sherwood Swan.)

The Witness: "Books of account"? I am sorry, but I don't keep personal books of account.

Q. (By Mr. Mather) Well, do you know from what information that document, Petitioner's Exhibit No. 10, was prepared?

A. A series of original documents and personal notes.

Q. Now, included in the liability side of that exhibit, Mr. Swan, is there any obligation with respect to the \$25,000 which you and Mr. Whitthorne borrowed to put up as collateral with the bank?

A. No, sir, there is not.

Q. What does the item to Harry Camp represent?

A. This \$7,500 due Harry Camp is an accumulation of items plus accumulated interest that had been advanced at one time and another from, I should judge, starting along in 1930 and continuing along through the summer of 1936.

Q. Was it a note?

A. There was no note given at that time. It was just an accumulation of items.

Q. What record did you have with respect to that item? [181]

A. Well, just memorandums, and I subsequently checked the memorandum of those items in the office of Harry Camp and verified this figure as an approximate figure.

Mr. Mather: That is all.

(Testimony of Sherwood Swan.)

Redirect Examination

Q. (By Mr. MacDonald) Mr. Swan, Mr. Mather on cross examination was querying with respect to another possible note other than the \$20,000 note to the Central Bank with respect to which you and Mr. Whitthorne might be liable as of December, 1936.

I ask you whether in the settlement of an old obligation with Mr. David Wasserman, of Sacramento, Mr. Whitthorne was liable on any of the obligation continued after 1930?

A. None whatever.

Q. I show you a copy of a letter from Mr. Whitthorne and yourself to Mr. Wasserman and a copy of a note dated December 1, 1930, for \$5,000, signed by you in favor of Mr. Wasserman, and ask you if those are true copies?

A. (Examining documents) To the best of my knowledge and belief, those are.

Mr. MacDonald: I ask that that be marked Petitioner's next in order to be given a single number.

Mr. Mather: No objection.

The Clerk: No. 17. [182]

(The said letter so offered and received in evidence was marked Petitioner's Exhibit No. 17, and is made a part of this record.)

Q. (By Mr. MacDonald) Mr. Swan, the bank officials and Mr. Robinson testified that the banks

(Testimony of Sherwood Swan.)

paid off Mr. Robinson the \$35,000 and accrued interest which was owing from you to him.

Were the banks shortly after that time reimbursed for that \$35,000 and interest so paid by them?      A. They were.

Q. How long after December, 1936, did Sherwood Swan and Company, Ltd., continue to pay dividends on its common stock?

A. Two years.

Mr. MacDonald: That is all.

Mr. Mather: If your Honor please, just one question I inadvertently overlooked.

#### Recross Examination

Q. (By Mr. Mather) I hand you, Mr. Swan, Petitioner's Exhibit No. 16, and ask you if that agreement was carried out in accordance with its terms?

A. I haven't read this agreement probably for more than four years.

I have some recollection that—having to do with some stock in addition to the 25,000 shares that Gersten & Company actually took; that there was an option or something [183] like that having to do with a portion, at least, of the balance, to-wit, 5000 shares, the difference between 25,000 shares and 30,000 shares of the A which wasn't in reality carried out.

With that exception, so far as I know this contract was carried out.

(Testimony of Sherwood Swan.)

Q. In 1937 did you have 2500 shares of class A stock standing in your name on the books of the corporation?      A. Yes, sir.

Q. Did Mr. Whitthorne?      A. Yes, sir.

Q. Do you still have that class A in your name?

A. Yes, sir.

Q. It has never been sold?

A. That is correct.

Q. The only stock that was sold was the 25,000 class A that we have been discussing here?

A. That is correct.

Q. Your explanation has to do with the balance of the class A, the 5000 which stand in the name of you and Mr. Whitthorne?

A. That is correct. [184]

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### FRANK G. SHORT

a witness called on behalf of the Petitioners, was duly sworn and testified as follows: [191]

#### Direct Examination

Q. (By Mr. MacDonald) Your name, sir.

A. Frank G. Short.

Q. And your occupation?

A. I am a Certified Public Accountant.

Q. How long have you been one?

A. Oh, I have been certified in this state for about eight years. I have been qualified as an ac-



(Testimony of Frank G. Short.)

countant for over 20. I am also a chartered accountant of Canada.

Q. Are you one of that group of accountants which are described as "Tax experts"?

A. I am not.

Q. What branch of the profession do you specialize in?

A. I am a general practitioner. I am fairly familiar with the—with practice before the Securities and Exchange Commission, but not otherwise.

Q. I hand you herewith Respondent's Exhibit B for identification, the filed income tax return of Mr. Swan for the year 1936, and I ask you if you know who prepared that?

A. (Examining document) I did.

Q. I forgot to ask this preliminary question, Mr. Short: With what firm are you associated?

A. I am the resident partner of Barrow, Wade, Guthrie & Company in this city. [192]

Q. Well, how did it happen that you prepared that return *rather one* of the men in your office who are specialists in tax matters?

A. Already in the course of the transactions, which have been the subject of evidence while I have been here, I had a close personal knowledge of them as they went along. Consequently many of the facts involved in this return were already known to me.

Q. There is attached to that return a somewhat

(Testimony of Frank G. Short.)

lengthy statement, twelve pages, as I recall it, setting forth the history of these transactions?

A. Yes.

Q. Did you prepare that?

A. I dictated it, yes.

Q. How does it happen that the return was prepared in that somewhat unusual form, rather than simply the filling in of blanks?

A. Well, as I mentioned before, I am not a tax expert. I don't know the answers to some of the points involved.

The transactions were very complicated, and I thought the best result, both for the client and the Government, would be obtained by giving a rather full memorandum of all the facts as I knew them. Then it appeared to me that even if I hadn't arrived at the right conclusion, that there was ample disclosure so that the matter could be ironed out [193] later.

Q. There is in that memorandum, Mr. Short, a purported allocation of cost between the A and B stocks.

Will you find that?

A. (Examining document) It is some time since I did this. I am sorry.

Yes, I have it.

Q. Did you prepare that?                      A. Yes.

Q. What was the basis of that allocation?

A. It was partly based on the equity in the book assets at December 31, 1936, and partly based upon

(Testimony of Frank G. Short.)

an allocation of the equity in the average earnings up to that point.

Q. It was in part, then, based on the book figures for the assets? A. That is right.

Mr. Mather: Now, if your Honor please, the witness, I think, should be permitted to testify. I object to that question.

Mr. MacDonald: All right, withdraw it.

Q. (By Mr. MacDonald) If you had known that the actual value, the fair market value of the assets was different from the book value, would you have used that same basis of apportionment?

Mr. Mather: That is objected to as irrelevant and [194] immaterial and not the proper subject of expert testimony.

The Member: Sustained. Was this witness tendered as an expert?

Mr. MacDonald: No, sir.

The Member: I sustain the objection, nevertheless. But I want to be sure that I understand.

Mr. MacDonald: I started to ask him, not to show that he was an expert, but my only purpose was to show that the allocation was based on book value and not on actual value of the assets.

Q. (By Mr. MacDonald) Since preparing that return have you acquired knowledge as to the fair market value of the assets of Sherwood Swan and Company, Ltd., as of December, 1936?

Mr. Mather: That is objected to as irrelevant and immaterial.

(Testimony of Frank G. Short.)

The Member: Sustained.

Q. (By Mr. MacDonald) In preparing that allocation, did you take into consideration the fair market value of the assets of Sherwood Swan and Company as of December, 1936?

Mr. Mather: That is objected to as irrelevant and immaterial.

The Member: Overruled.

The Witness: Will you please define the fair market value before I answer the question, please?

[195]

Q. (By Mr. Macdonald) The fair market value is that value which is reached by a willing buyer and a willing seller in the market for the asset in question.

A. The answer to that question, then, is "No".

Q. In your opinion, was there any fair market value in December, 1936, for the Class B stock?

Mr. Mather: That is objected to as calling for a conclusion of the witness.

The Member: Sustained.

Q. (By Mr. Macdonald) Mr. Short, was there some question asked Mr. Swan as to whether or not all of the A stock which was marketed by Messrs. Whitthorne and Swan to Miller and Company was resold by Miller and Company to the public?

Have you any knowledge as to that?

A. Yes.

Q. What is your knowledge?



(Testimony of Frank G. Short.)

A. It was not all sold to the public, using the term "sale" in its ordinary sense. I know——

Q. (Interposing) I don't hear you.

A. It was not all sold to the public, using the term "sale" in its ordinary sense.

I know of at least one block, 1200 shares, I believe, which was used by them to settle a debt.

The Member: By whom?

The Witness: By Miller and Company, later Gersten & [196] Company.

The Member: To settle a debt?

The Witness: Yes. The shareholder concerned lives in Santa Barbara. I don't know his name.

Q. (By Mr. Macdonald) You have testified that you prepared that return.

Over what period of time were you engaged in its preparation, Mr. Short?

A. (Examining document) I commenced to give it some consideration at some date which I can't now remember, early in 1937. I commenced active work on it on March 18, 1937, and finished on May 29, 1937.

Q. How was it it took that length of time to prepare?

A. Well, there were a great many occasions when I was lacking in information, and I had to put my difficulty up to Mr. Swan to supply the information, and that involved delay while he was getting it. I was busy on it fairly continuously during that period but with substantial gaps between work.



(Testimony of Frank G. Short.)

Q. On what date did you say the return was finally completed?      A. May 29, 1937.

Q. What day of the week was that?

A. Saturday.

Q. What was the next business day? [197]

A. The next business day was the following Tuesday, Monday being a holiday, Decoration Day.

Q. Tuesday, June 1?      A. Tuesday, June 1.

Q. What did you do with the returns on that day?

A. They were delivered to Mr. Swan at our office.

The Member: On June 1.

The Witness: On June 1.

Q. (By Mr. Macdonald) What returns do you mean when you say "they"?

A. There were four returns involved, Messrs. Swan and Whitthorne and their wives.

Q. What knowledge, if any, have you with respect to the notarying of the returns?

A. My signature was authenticated by our Notary on June 1 on all four returns. Mrs. Swan's was also authenticated by our notary. The other three returns at that time were unsigned.

Q. On what date was Mrs. Swan's notaried?

A. The same date as mine, that is, June 1.

Q. Under what circumstances did you deliver the returns to Mr. Swan on June 1?

A. Well, he came to the office to get them. I had a short conversation with him. He took them away to get them signed and filed. [198]

(Testimony of Frank G. Short.)

The Member: I may have misunderstood you. Did you say that the Notary took Mrs. Swan's signature on the same day as yours?

The Witness: Yes.

The Member: Or Mr. Swan's?

The Witness: Mrs.

Mr. Macdonald: The wife, yes, sir.

The Witness: Yes.

The Member: But you delivered the returns all to Mr. Swan on that day?

The Witness: Right, including Mrs. Swan's.

Q. (By Mr. Macdonald) Have you any recollection as to the hour of the day?

A. I believe it was the morning.

Q. What is your knowledge with respect to the matter of extensions for the filing of these returns?

A. On March 15th I obtained without difficulty one month's extension, as I remember it. Possibly it is attached.

On April 15th, in spite of a good deal of work, I was nowhere near finished, and I applied, I believe, for a two-month extension and was granted a month and a half. That particular extension had a big rubber stamp, "Final Extension" on it, as I recall it.

The Member: Well, is that the way it was expressed, [199] a month and a half?

The Witness: No. It was to a particular day, which was June 1st.

Mr. Macdonald: Cross examine.

(Testimony of Frank G. Short.)

Cross Examination

Q. (By Mr. Mather) Mr. Short, where did you obtain your information with respect to the block of 1200 shares of stock that you testified to?

A. I mentioned earlier that I was to some extent in the middle of these transactions at the time they had taken place, and I was consulted not merely by Mr. Swan but by Mr. Gersten at the same time. I had some knowledge of their affairs and their difficulties, too.

Q. Now, was my question clear?

A. You asked under what circumstances?

Q. No. I asked where you obtained your information.

A. Oh, I see. I obtained it from Mr. Gersten.

Q. Mr. Gersten told you about it?

A. Yes.

Q. Now, I show you, Mr. Short, Respondent's Exhibit A for identification and ask you if that document was certified to by your firm?

A. (Examining document) It was. That is my signature.

Mr. Mather: No further cross examination.

Mr. Macdonald: Just one moment. (Examining document) [200]

That is all, Mr. Short.

(Witness excused.)

Mr. Macdonald: Mr. Foley.

U. R. FOLEY

a witness called on behalf of Petitioners, was duly sworn and testified as follows:

Direct Examination

Q. (By Mr. Macdonald) Your name is——

A. U. R. Foley.

Q. And your occupation?

A. I am the controller at Sherwood Swan and Company.

Q. How long have you occupied that position?

A. I have been with the firm since 1925.

Q. And have been Controller for what period?

A. I have been Controller for the past five years.

Q. As part of your duty as Controller, do you keep the books of the Company?

A. Yes, sir.

[201]

The Member: Let me ask the witness: Is that balance sheet entirely a book balance sheet, or is it adjusted to actual or fair market or other value, other than what the books show?

The Witness: It is taken directly from the books.

The Member: That balance sheet, then, is a correct transcript of the results of the books; is it?

The Witness: Yes, your Honor.

The Clerk: Exhibit 18.

(The said audit report so offered and received in evidence was marked Petitioner's Exhibit No. 18, and is made a part of this record.)

The Member: And that is as of what date?

[203]

Mr. Macdonald: December 31, 1936. [204]



## FRANK G. SHORT

a witness on behalf of Petitioners, having been previously duly sworn, testified further as follows:

## Direct Examination

Q. (By Mr. Macdonald) Mr. Short, you have in your hands Petitioner's Exhibit 18. Did you prepare that?

A. It was prepared partly by myself and partly by assistants working under my supervision.

Q. Then you are familiar with it and know what it is you have before you and what you are talking about?

A. I am. I personally signed the report in front of me.

Q. The Court was endeavoring to relate this to the statement attached to Respondent's Exhibit A for identification. That is the prospectus.

Mr. Foley, the previous witness, testified that the one in Exhibit A was a consolidated one. Is that correct? A. Is this—— (pause)

Q. No, this (indicating).

A. That is a consolidated one.

Q. What is your testimony with respect to whether [210] Petitioner's Exhibit 18 is consolidated or not?

A. Well, this volume includes two balance sheets. The one Mr. Foley was looking at rather intently is an unconsolidated balance sheet.

A little later on in the volume you will find the consolidated balance sheet, and it is the second one that is comparable to that.



(Testimony of Frank G. Short.)

The Member: Now, you point out the second one which you say is comparable to the prospectus consolidated balance sheet.

Q. (By Mr. Macdonald) Give the page number and read the heading into the record.

A. These have no page numbers, I am sorry to say.

This is entitled "For filing with the Securities and Exchange Commission" and was done in accordance with their regulations.

The Member: Have you got it before you now?

The Witness. Yes. I can read its title.

The Member: Let that be marked, Mr. Clerk, as Exhibit No. 19, which although it is a part of No. 18, identifies it as the one the witness is talking about.

Mr. Macdonald: That will be helpful.

The Member: Will you read it to the clerk?

The Witness: May I read the caption into the record? [211]

The Member: Well, that is not important, as long as it is identified. The mark is best.

The Clerk: Mark it for identification 19.

The Member: Not "for identification". This is an exhibit that is in evidence, and it is No. 19.

(The said sheet contained in Petitioner's Exhibit 18, so offered and received in evidence, was marked Petitioner's Exhibit No. 19 and is made a part of this record.)

(Testimony of Frank G. Short.)

The Member: So that 19, Mr. Witness, and A, except for the difference in dates, cover the same ground; is that right?

The Witness: They do, except that there was a statutory merger of one of the subsidiaries with the parent during the intervening period, but the business remained unchanged. All of the affairs of the parent company were still in both statements.

The Member: The balance sheet of three companies of October 31, 1936, became the balance sheet of two companies on December 31, 1936; is that right?

The Witness: Yes, but without any basic change in the character of the business.

The Member: All right. Now, who has got the witness?

Mr. Macdonald: Mr. Mather.

Mr. Mather: No cross examination. [212]

Mr. Macdonald: That is all, Mr. Short.

(Witness excused.)

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Mr. Macdonald: Mr. Swan.

The Member: Were you through with the witness Foley?

Mr. Macdonald: Yes, sir.

The Member: Are you through, Mr. Mather?

Mr. Mather: Yes, sir.

Mr. Macdonald: Mr. Swan.

SHERWOOD SWAN

a witness recalled on behalf of Petitioner, having previously been duly sworn, testified further as follows:

Direct Examination (Continued)

The Member: You are going into the reasonableness now?

Mr. Macdonald: That is all.

The Member: Has it been made clear in the record either by my own questions or somebody else's as to what I asked of earlier witnesses, as to what was the origin of the indebtedness of Whitthorne and Swan to the bank?

If that hasn't been clear, or there is any doubt about it, I wish you would clear it up.

Mr. Macdonald: The only doubt I have is what you mean by "origin".

We read into the record the list of indebtedness to [213] the bank, and we stipulated that was correct.

The Member: That is not what I want. Perhaps I can ask the witness myself.

At the time that you were indebted to Robinson for \$35,000, and also to the banks—that is, as I recall, it goes back to 1930—will you state what the indebtedness to the banks was for, how it arose, that is, as to whether you borrowed the money or what you did?

The Witness: In the winter of 1927 Mr. Whitthorne and I borrowed \$100,000 from the Bank of America—it might have been the Bank of Italy

(Testimony of Sherwood Swan.)

at that time—but it was the bank that became the Bank of America, in the event that there was a difference in name, as a part payment on the purchase of a corporation in Sacramento, a store called “Wasserman-Gattman Co.”

In the spring of 1928 Mr. Whitthorne and I borrowed from the Central National Bank in Oakland—I don’t recall the exact amounts that we borrowed at the time—but there were original borrowings and then there were additional borrowings to purchase a business in Oakland called “Upwrights” which we changed the name of to “Swan’s, Inc.”

Swan’s, Inc. lost money, and about a year after the spring of 1928, which would be in the spring of 1929, we borrowed additional funds from the Central Bank, and we merged the Wasserman-Gattman Corporation and Swan’s, Inc., [214] and ran the Sacramento and the Oakland stores as one corporation.

At various times before the public we operated under the name of “Swan” and subsequently when a sub-tenant of ours got into financial difficulties we ran it before the public, for the purpose of capitalizing whatever the good will of the tenant’s name was, under the name of Swan and Gerwin, but the corporate entity at that time was Wasserman-Gattman Co.

The Member: So that these indebtednesses to the banks were what was left of the actual cash borrowed to create them?



(Testimony of Sherwood Swan.)

The Witness: That is correct, to put it in these mercantile businesses which——

The Member: (Interposing) But so far as the banks were concerned, you got money from the banks and you owed them, had to repay it?

The Witness: That is correct.

The Member: And that continued to be so down through 1930, and from then on, until 1936?

The Witness: That is correct.

The Member: And the \$35,000 which you owed to——

The Witness: (Interposing) Robinson.

The Member: (Continuing)——Robinson, how did that originate? Was that by a borrowing of money?

The Witness: Yes. We borrowed—Whitthorne and I [215] borrowed some money which we loaned to Sherwood Swan and Company to buy a piece of property which is at present, and was as of 1930, a part of the Tenth Street Market property.

The Member: That is all I wanted to know.

Mr. Macdonald: That is helpful, sir. Thank you.

Q. (By Mr. Macdonald) Now, Mr. Swan, directing your testimony to the matter of the filing of these four returns, Mrs. Whitthorne's, Mr. Whitthorne's, and Mrs. Swan's and yours, Mr. Short has testified that he completed the returns on Saturday, May 29, 1937, and delivered them to you on Tuesday, June 1, 1937, Mr. Short having obtained and notaried the signature of Mrs. Swan, the other ones unsigned.



(Testimony of Sherwood Swan.)

Will you carry on the story from there on, to the best of your memory, with respect to what was done with those returns?

A. Well, my recollection is that as of the same date, June 1, that our signatures, to-wit, Whitthorne's and Mrs. Whitthorne's and my own were notaried by Wallace Knox in Oakland.

I have our corporation's check which I was fortunate enough to find in our files.

Mr. Macdonald: Let me show it to Mr. Mather before you testify, please. (Obtaining document from witness.) [216]

Q. (By Mr. Macdonald) You have produced a check dated June 1, 1937, drawn by Sherwood Swan and Company, Ltd., to the Collector of Internal Revenue for the sum of \$423.64.

Can you state in payment of what that check was drawn?

A. Well, inasmuch as this was June 1, my recollection is that Mr. Short told me that we would be obliged to pay one-half of the tax for the year for which this check was issued, which is Mrs. Swan's income tax for the year 1936.

Mr. Macdonald: I would like to offer in evidence as Petitioner's next in order this check.

Mr. Mather: I have no objection.

The Clerk: Exhibit 20.

(The said check so offered and received in evidence was marked Petitioner's Exhibit No. 20 and is made a part of this record.)

(Testimony of Sherwood Swan.)

Q. (By Mr. Macdonald) The signatures to that check are whose?

A. Mr. Foley, U. R. Foley's and my own.

Q. And the remaining writing on that check is whose?

A. This is one of the clerks in the office (indicating).

Q. You can identify her by the handwriting?

A. I discussed the matter in the office, and while I don't know the name of the Clerk, my understanding from discussing the matter in the office that it was our relief clerk who ordinarily draws checks after the other regular clerk has [217] gone home.

Q. At what time of day?

A. The regular clerk who draws the checks leaves at a quarter of five because she comes in early in the morning; goes home early.

Q. After you had these four returns then notaried, Mrs. Swan's in San Francisco, the other three you have testified by Mr. Knox in Oakland, and this check, what further did you do?

A. Well, my general recollection is that those statements were taken to the Internal Revenue Department and an attempt made to file them.

Q. Where?

A. In the Post Office Building in Oakland; an attempt made to file them.

This is recollection, and it is—I admit it is just a little bit hazy in my mind. But after digging up the check, after digging up the notarial record, my

(Testimony of Sherwood Swan.)

impression is that I attempted to file them, and being unable to file them they were slipped through the slot in the door in the office. I personally have a definite objection to filing statements of that kind by mail. I have no recollection of having filed a personal statement by mail.

I have a more or less series of recollections of always having filed statements, personal income tax statements [218] in person. And upon one of these occasions I put it through the slot in the door, and my feeling is that it could have been—this particular time—although from the point of view of my saying that I am absolutely positive that this was the occasion, I am sorry I cannot do that.

Mr. Macdonald: We do not want you to testify to something you cannot remember.

Cross examine.

### Cross Examination

Q. (By Mr. Mather) Mr. Swan, I do not know that I am entirely clear with respect to the \$35,000 transaction.

Now, is it your testimony that that \$35,000 obligation was paid by you and Mr. Whitthorne in 1930?

A. A dividend was declared from the funds of Sherwood Swan and Company in 1930, and my recollection is that the stock—now, this is in terms of its being actually whether the checks were drawn to Whitthorne and me, or whether the checks were drawn to the banks in whose name it stood sooner or

(Testimony of Sherwood Swan.)

later with—whether they were originally drawn in the bank's name, or whether they were drawn in Whitthorne's and my name, depending on how that stock was issued, when it was released from Mr. Robinson over to the banks, I don't recall. But in any event, a dividend was declared for such a sum of money as would repay the loan were sent and paid to the banks. [219]

Q. Paid to the banks?           A. Yes, sir.

Q. And the banks then paid Robinson?

A. That is correct, sir.

Q. At that time was——

Mr. Macdonald: (Interposing) May I interrupt just a second? Because neither of us wants to get the record confused.

You say the banks then paid Robinson?

Mr. Mather: Yes.

Mr. Macdonald: If you will forgive me for stating the fact from counsel table, the banks paid Robinson first and were reimbursed by this means.

Q. (By Mr. Mather) Well, Mr. Swan, was this thousand shares of Sherwood Swan up as collateral for the \$35,000 obligation to Robinson?

A. Yes, sir.

Q. Was it also up as collateral for loans to the bank?           A. No, sir.

Q. All right. Was the \$35,000 obligation to Robinson paid by you prior to the time the stock was put up as collateral to the bank?

A. No, sir. It was done subsequently.



(Testimony of Sherwood Swan.)

Q. Well——

A. (Interposing) With corporation funds paid out in a [220] dividend.

Q. Yes. But do I understand that the obligation to Robinson was paid off prior to the stock being placed as collateral with the bank?

A. Now, the actual machinery of that, I haven't looked into it from that point of view ever. It is ten years ago. In order to know specifically whether Robinson was paid off first before it went to the banks or whether it was paid—whether Robinson was paid off via the dividend route, my mind isn't entirely clear on that.

If you will permit me, I will recite as nearly as I can exactly what took place.

Q. That is what I would like to have you do, Mr. Swan.

A. We had been indebted for many years to Mr. Robinson, and I stated to the Court a moment ago how the debt originated.

After the Wasserman-Gattman Company got into trouble and these series of discussions took place, to which Mr. Robinson and Mr. Wainwright testified this morning, arrangements were made for the banks to reimburse Mr. Robinson and take over the stock, the thousand shares of Sherwood Swan and Company stock.

Now, there was a notice filed so that it would have appeared to take the form of a sale, of a pub-



(Testimony of Sherwood Swan.)

lic sale; the motions were gone through before the world; made that appear [221] as a matter of form. The stock was duly delivered to the respective banks, 500 to each bank—500 shares to each bank.

Now, just when Mr. Robinson was paid I can't tell you, excepting that in due time a dividend for the amount of \$35,000, or a series of dividends for \$35,000, plus the accumulated interest, was paid to the banks and the banks paid Mr. Robinson.

Now, whether they paid him before the dividend was declared or after the dividend was declared, it is not clear in my mind. I have never gone back and looked up the details of it, and it is ten years ago.

Q. In any event, it was right along in '30 or '31?

A. My recollection is that it was in 1930.

Mr. Mather: That is all.

Mr. Macdonald: That is all, Mr. Swan.

The Member: We will take five minutes recess.

(Whereupon a brief recess was taken after which proceedings were resumed as follows:)

Mr. Macdonald: Just one question, Mr. Swan, arising out of cross examination.

### Redirect Examination

Q. (By Mr. Macdonald) Mr. Mather raised the question with reference to securities deposited by you with the bank, the Anglo bank, to secure the performance of the [222] agreement of sale of the stock under Petitioner's Exhibit 16.

(Testimony of Sherwood Swan.)

What was deposited with the Anglo bank?

A. There were two checks, one for \$15,000 from Harry Camp and one for \$10,000 from either Tom Riley or, T. C. Riley—I have forgotten what the initial is—for \$10,000, \$25,000 in all.

Q. When the sale was completed, when all the stock was sold, what was done with respect to that money so deposited?

A. It was promptly repaid.

Q. To those individuals?

A. To those individuals, \$15,000 to Camp and \$10,000 to Riley.

Q. Do you show on the statement of assets and liabilities as of December 16th herein, either that \$25,000 as an asset of yours or the obligation to repay the same as a liability?

A. No. I explained to Mr. Mather that I didn't keep books, and I ought to be scolded for it. But it is true, nevertheless. I never kept any personal books. I have notes and memorandums in my files, and I completely—I didn't consider either the assets side or the liability side on that transaction. In other words, I looked upon it as a wash transaction.

Q. What do you mean by "wash transaction"?

A. \$25,000 cash on one side and \$25,000 of notes on the [223] other that were used for a specific purpose and cleaned up and forgotten.

Mr. Macdonald: That is all.

(Witness excused.)

Mr. Macdonald: Mr. Murphy. [224]

The Clerk: That will be exhibit A.

(The said prospectus so offered and received in evidence was marked Respondent's Exhibit A, and is made a part of this record.)

Mr. Mather: I also offer in evidence the document marked "Respondent's Exhibit B for identification."

Mr. Macdonald: No objection.

The Clerk: Exhibit B.

(The said tax return so offered and received in evidence was marked Respondent's Exhibit B, and is made a part of this record.)

Mr. Macdonald: That is the tax return?

Mr. Mather: The tax return.

Mr. Macdonald: Very well.

Mr. Mather: Respondent rests.

The Member: Nothing in rebuttal?

Mr. Macdonald: No, sir. [230]

## PETITIONERS' EXHIBIT 1

San Francisco, California,  
March 14, 1930.

Mr. J. F. Carlston, President,  
Central National Bank,  
Oakland, California.

Dear Mr. Carlston:

It has just come to us that you contemplate asking Mr. Swan and Mr. Whitthorne to obligate the

securities recently pledged to you for an additional sum over the specified \$100,000.

This report leads us to mention our definite understanding in this regard that neither you nor we would look to the securities thus pledged to us in equal amounts for more than the \$100,000. each, this agreement being predicated upon our common judgment that it was mutually advantageous that Mr. Swan and Mr. Whitthorne should look forward to realizing for themselves upon any equity produced from the securities pledged over and above the total sum of \$200,000. We also have in mind that both Mr. Swan and Mr. Whitthorne pledged these to you and to us in the face of our mutual agreement referred to.

It is easily conceivable that this understanding may have escaped your memory at the moment. We accordingly are taking the liberty of thus mentioning it and also because we recognize the obligations thus entered into with Mr. Swan and Mr. Whitthorne as well as the advantages to you and to us of preserving an incentive for their continued endeavor.

Kind personal regards.

Cordially yours,

OSCAR L. COX,  
Vice-President.

OLC:FCE

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 1. [231]

PETITIONERS' EXHIBIT 2

Central National Bank  
Oakland, Calif.

March 15, 1930.

Mr. Oscar Cox, Vice-President,  
Bank of Italy Natl. Trust & Savings Assn.,  
San Francisco, California.

My dear Mr. Cox:

Responding to your letter of the 14th inst.

You are quite right in the assumption that we were to hold the collateral described in our new \$100,000.00 note, as security for this specific obligation. It was not intended, however, to forgive the indebtedness due by the individuals in excess of this amount. In other words, we are to continue to hold the Hale Bros. stock as security for such of the indebtedness as is in addition to the \$100,000 note. This I assume is in accordance with your understanding.

With kindest regards—

Yours very truly,

(signed) J. F. CARLSTON

President.

JFC:B

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 2. [232]



## PETITIONERS' EXHIBIT 3

Bank of Italy

San Francisco, California

September 16, 1930.

Central National Bank

Oakland, California

Attention: Mr. Wainwright

Dear Mr. Wainwright:

Confirming our telephone conversation of today, our banks are in entire accord that some while ago we set at \$100,000. each the maximum principal amount of the indebtedness of either Mr. Swan or Mr. Whitthorne or both, for reimbursement of which we would look to Sherwood Swan & Company or the Sherwood Swan Company. This understanding occurred in the Spring, and it seemed that March 12 should be an appropriate date for setting aside out of our indebtedness from these individuals the sum of \$100,000. in accordance with the above.

On July 1, 1930 we received from Mr. Swan the sum of \$2,783.67, being one-half of certain funds owing as a receivable and paid to Mr. Whitthorne. This amount was applied as follows:

Interest from March 12 to July 1.....	\$ 1,850.00
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For application upon principal.....	933.67
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\$ 2,783.67

Leaving principal amount due.....	\$99,066.33
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On this latter amount the interest from July 1, 1930 to October 1, 1930 amounts to \$1,489.13, and the interest thereafter per average month would be \$495.33.

Accordingly, it is my suggestion that at this month's meeting a dividend of twice the larger amount be declared, and a dividend authorized for each succeeding month of twice the lesser amount. This would provide service on both of our obligations for the remainder of the agreed amount, and it would be our purpose to set up these amounts as received as an interest reserve as against these notes, and at such later time as it may seem advisable the direct application could be made.

I mention all of the above for two purposes, first, to suggest that we reduce our \$100,000. obligation to some agreed sum, preferably to the one that we have used if you find the March 12 date a fair one to begin, and second, that the dividends mentioned above be declared at the next meeting. In connection with this latter matter I have clearly in mind that you and we are each fifty percent stockholders in the corporation and that if the situation should arise in which it seemed necessary and advisable that the company have additional funds, it would be a simpler transaction if the corresponding advances were made at that time and devoted to the special purpose then before us. [233]

I thank you for the word as to Mr. Swan's attitude toward his assignment and our keeping up the payments on some part of his life insurance.

When the matter has had your and his further consideration I would be interested in the result. Without close knowledge of the situation it would seem to us that our taking over some part of the \$250,000. you mention might easily be in the interests of both parties.

Cordially yours,

OSCAR L. COX (Signed)

Vice-President

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 3. [234]

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#### PETITIONERS' EXHIBIT 4

April 22, 1931

Mr. Sherwood Swan  
H. Liebes & Co.  
Post and Grant Street  
San Francisco, California

Dear Sherwood:

I have gone over a draft of agreement to be signed by Central National Bank of Oakland, Mr. Whitthorne and yourself with relation to the indebtednesses of Mr. Whitthorne and yourself or either of you to the bank.

Before the liquidation of Wasserman-Gattmann Co. was commenced, several conferences were had in Mr. Carlston's office all of which were attended by Mr. Carlston, Mr. Cox, you and the writer. The

final net result of those discussions was that you and Mr. Whitthorne would cooperate in every possible way both with the general creditors of Wasserman-Gattmann Co. and with your banking creditors to the end that the creditors of Wasserman-Gattmann Co. should receive as nearly as possible the full amount of their claims and be satisfied to accept in full payment of their demands the proceeds of the liquidation of the corporation named. The accomplishment of this purpose would make available for the banking creditors of Mr. Whitthorne and yourself the profits of the 10th Street Market and the value of the equity represented by the stock of the corporation owning it.

At the same time and as a part of the same arrangement, it was stated by the representatives of your banking creditors that every reasonable aid and assistance would be given you and Mr. Whitthorne in the working out of your financial situation so that you might ultimately recover for yourselves the 10th Street Market after having paid off to each of your banking creditors such sums as, under the circumstances, might fairly be allocated against the market stock.

Pursuant to the foregoing you and Mr. Whitthorne executed to the Central National Bank of Oakland your joint and several promissory note for \$100,000.00 and secured its [235] payment by the pledge of certain stock in Swan's, a California corporation, in Wasserman-Gattmann Co., and (the important security) 500 shares or one-half of the



stock of Sherwood Swan & Company, Ltd. The pledge of 500 shares of stock of Sherwood Swan & Company, Ltd. was subject to a prior pledge to the writer of this letter. Sometime in the year 1930 the writer sold this stock under his pledge and on August 1, 1930 the writer sold this 500 shares to the Central National Bank of Oakland and certificate No. 33, representing the same was issued to George C. Humphrey.

From what was said and done in 1930, including the conferences first mentioned in this letter and the execution by yourself and Mr. Whitthorne of the \$100,000.00 note secured by 500 shares of stock of Sherwood Swan and Company, Ltd., it was your understanding (an understanding which I share) that if you and Mr. Whitthorne were able to pay off the above mentioned \$100,000.00 note and a similar \$100,000.00 note, at the same time executed to the Bank of Italy, and the two banks were reimbursed in the sum of \$35,000.00 and certain interest, which you and Mr. Whitthorne owed me, and for the payment of which all the stock in Sherwood Swan and Company, Ltd. was primarily pledged, you and Mr. Whitthorne would be given an opportunity to recover the stock of Sherwood Swan and Company, Ltd. In the very nature of things nothing was said and nothing could specifically have been said regarding the length of time during which the banks would wait for the working out of the market problem and the repayment to them of



\$200,000.00 secured by its stock. It was recognized that the equity in the market was small in proportion to the indebtedness against the real estate; that without refinancing of the real estate obligations there was not much hope of cleaning up the situation so that you and Mr. Whitthorne could repurchase the stock of Sherwood Swan and Company, Ltd.; but it was also indicated that in determining how long the banks would wait for such refinancing fair consideration would be given to the completely cooperative conduct of Mr. Whitthorne and yourself. I believe the foregoing is an accurate statement of what came out of the conferences between your banking creditors and yourself in the spring of 1930. [236]

It is to be noted that the note for \$250,000.00 attached to the proposed agreement consolidates all of the security heretofore pledged, which means that the allocation of \$100,000.00 against the Central National Bank's half of the market stock is eliminated.

I note also that \$20,000.00 now owed by you separately is made a joint obligation of Mr. Whitthorne and yourself.

It appears also that the interest rates on your primary obligations are maintained at 6%. The present Hale dividends service \$150,000.00 at 4%; the present market dividends service \$100,000.00 at 5% and \$20,000.00 at 5%. With the obligations in the primary notes running at 6% you have a con-

stantly accumulating arrearage of interest which makes progressively unlikely your ever cleaning up your financial obligations in full.

I also note that you purport to pledge 500 shares of stock in Sherwood Swan & Company, Ltd., which, so far as I know, do not belong to you. Of course, there are ways of making provision to cover this last point but as matters now stand you have, so far as I know, no legal interest in the shares of stock mentioned.

You have asked me to read over the draft of agreement submitted to you and to advise you regarding the meaning of the same. In doing so I have found it necessary to review the whole situation rather extensively. I suggest that the whole matter is an appropriate subject of conversation between Mr. Carlston and yourself.

Very truly yours,

HARRISON S. ROBINSON

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 4. [237]

PETITIONERS' EXHIBIT 5

Bank of America N. T. & S. A.

San Francisco, California,

April 24, 1931.

Mr. Harrison S. Robinson,  
Financial Center Building,  
Oakland, California.

Dear Harrison:

Referring to your letter of April 23, 1931 and the attached copy of a proposed letter to Sherwood Swan dated April 22, it was definitely understood in conference and has been confirmed in correspondence with the Central National Bank that neither the Central nor ourselves would look to the Tenth Street Market situation for more than \$100,000 to each of us. It may be that the general pledge and consolidation of debt should be supplemented by the Central giving Mr. Swan a letter to this effect. Mr. Swan is welcome to access to our files to substantiate that the agreement was made as mentioned.

We assume that Mr. Swan will not pledge the 500 shares of Sherwood Swan and Company, Ltd. without finding a way to make a similar pledge to us should we prefer.

I am not altogether clear as to the apparent duplication of notes mentioned in the second paragraph of your letter, but recognize that this is not a matter with which we are directly concerned. I see no impolicy in addressing your letter to Mr.

Swan, assuming of course that neither he nor you will understand that we are recognizing an obligation to hold the Market stock for any given period. We have no such obligation. On the other hand, we have assured Mr. Swan that as long as we have the stock we shall be glad to surrender it to him when we have realized \$100,000 principal therefrom.

Cordially yours,

OSCAR L. COX

Vice-President

OLC:FCE

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Pet.'s Ex. 5. [238]

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PETITIONERS' EXHIBIT 6

Bank of Italy

National Trust & Savings Association

Head Office

San Francisco, Cal.

San Francisco, California,

May 20, 1931.

Mr. Sherwood Swan,

167 Post Street,

San Francisco, California.

Dear Sherwood:

Complying with your request of May 16, 1931, we enclose copies of certain correspondence, being

letter dated March 14, 1930 to the Central National Bank and Mr. Carlston's reply under date of March 15, 1930.

You already have copy of our letter of September 16, 1930 to the Central National Bank, to which their reply was a verbal assurance of Mr. Wainwright to our Mr. Johnson who reported to us as follows under date of September 23:

"Mr. Wainwright stated also, he was in full accord with your letter of September 16 addressed to his attention and that the Central Bank was willing to accept the figures outlined in that letter and the dates suggested, as a basis for all future payments."

Cordially yours,

O. L. COX,

Vice-President.

OLC:FCE

2 Encls.

cc—Mr. Harrison S. Robinson.

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 6. [239]



## PETITIONERS' EXHIBIT 7

Bank of America  
National Trust & Savings Association

Oscar L. Cox  
Vice-President

San Francisco, California,

June 1, 1931.

Mr. Sherwood Swan,  
167 Post Street,  
San Francisco, California.

Dear Mr. Swan:

Enclosed is the agreement submitted to you and Mr. Whitthorne by the Central National Bank, and which you sent us in your letter of May 28, 1931 with request as to whether this agreement would prejudice your position with us.

It is our desire to accommodate ourselves to the convenience of Mr. Carlston and his associates as you know, but we should regret to see you obligate yourselves so that:

1. Your total outstanding notes would exceed your total debt, and,

2. One-half the stock previously held by you in Sherwood Swan & Company, Ltd. would be pledged for more than \$100,000.

As to the first point, I take it that the multiple notes are intended to provide immediate payment of 4% and/or 5% but an ultimate payment of 6%. It would seem to us that the ultimate result should

be obtained by a covering letter and a single series of notes. As to the second point, that was covered by definite agreement made in your presence in the early stage of the Whitthorne-Swan negotiations and was confirmed in an exchange of letters between Mr. Carlston and the writer, copies of which we are pleased to hand you.

In view of the cordial cooperation of the Central National in the various mutual matters which we have had in connection with the undertakings in which you have been interested, and as this letter has at your invitation discussed certain of their procedure, it seemed appropriate to send a copy of this letter to Mr. Carlston and a carbon is therefore attached for your delivery.

Kindest regards!

Cordially yours,

O. L. COX,

Vice-President.

OLC:FCE [240]

Robinson, Price & Macdonald  
Attorneys at Law  
Sixteenth Floor  
Financial Center Building  
Oakland, California

August 12, 1931

Mr. Sherwood Swan  
167 Post Street  
San Francisco, California

Dear Sherwood:

I am returning you herewith your letter to me dated July 31, 1931 with its inclosed notes and memorandum from the Central Bank. I am also sending you herewith Mr. Cox's letter to me on the same subject matter dated August 7, 1931.

I have the following comments to make:

1. Both banks seem to desire to use unmodified their printed form of collateral security agreement. Which contains a blanket clause stating that the enumerated securities and collaterals are **also security** for any other notes which the signer of the collateral agreement may make.

It is not improbable that under all the circumstances both banks would be held to their contract to limit the charges against the Tenth Street Market stock to \$200,000.00 and interest. The absolutely safe protection for you would be an additional clause in the contract between you and the two banks stating expressly that any clause in any collateral security agreement reciting that any of the

market stock is further security for any notes other than the \$100,000.00 to each bank is not operative as to any market stock.

The next most satisfactory procedure would be a letter from you accompanying the notes, calling attention to the printed form under discussion, stating that the special agreement excepts all market stock from the operation of such clause and asking the confirmation of that statement by the banks.

2. This brings us to the matter of the \$1150.00 note. The Central Bank, as I understand it, is clearly violating the arrangement regarding the application of dividends received from the market stock in not applying [241] the whole of the same to the \$100,000.00 which has been allocated against the market. If there is a deficiency in interest doubtless it is in order for you to sign a note for such deficiency but, as I see it, it is clearly out of order for you to sign a collateral trust agreement pledging the market stock for the \$1150.00 note.

Very truly yours,

HARRISON S. ROBINSON.

[242]

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## PETITIONERS' EXHIBIT 9

Description of Real Property of Sherwood Swan and Company, Ltd. Held in December, 1936.

All that certain real property situate in the City of Oakland, County of Alameda, State of California, more particularly described as follows:

Commencing at the intersection of the Westerly line of Washington Street with the Southerly line of Tenth Street; thence Westerly on said line of Tenth Street three hundred (300) feet to the easterly line of Clay Street; thence Southerly on said line of Clay Street one hundred (100) feet; thence easterly parallel with the said line of Tenth Street seventy-five (75) feet; thence Southerly parallel with said line of Washington Street one hundred (100) feet to the Northerly line of Ninth Street; thence easterly on said line of Ninth Street seventy-five (75) feet; thence Northerly parallel to said line of Washington Street one hundred (100) feet; thence easterly parallel with said line of Tenth Street one hundred (100) feet to said Westerly line of Washington Street; thence Northerly on said line of Washington Street one hundred (100) feet to the point of commencement.

[Endorsed]: U. S. Board of Tax Appeals. Admitted in Evidence October 21, 1940. Petitioner's Exhibit 9 [243]



# PETITIONERS' EXHIBIT 10

Sherwood Swan

## STATEMENT OF ASSETS AND LIABILITIES

December 16, 1936

(Based upon lack of any fair market value for common stock)

### ASSETS

#### Current Assets:

Due from Sherwood Swan & Company, Ltd..... \$ 9,835.12

#### Investments:

Sherwood Swan and Company, Ltd. capital  
stock—500 shares—fair market value (ex-  
changed on December 21, 1936 for 15,000  
Class A shares having fair market value of  
\$7.00 per share and 22,500 shares common  
stock) .....\$105,000.00

Ranch situated in Madera County, California —held under mortgage by Bank of America (contra)—approximate market value.....	6,000.00	111,000.00
		<u>\$120,835.12</u>

### LIABILITIES

#### Current Liabilities:

##### Notes payable—

Bank of America—secured by first mortgage  
on ranch situated in Madera County, Cali-  
fornia (contra) .....\$ 10,000.00

Central Company (one-half of joint indebt-  
edness of Sherwood Swan and W. R.  
Whitthorne totaling \$20,000)..... 10,000.00

Anglo California National Bank (one-half  
of joint indebtedness of Sherwood Swan  
and W. R. Whitthorne in the respective  
total sums of \$175,000 and \$5,000)..... 90,000.00

David S. Wasserman.....	5,000.00	\$115,000.00
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## Accounts payable—

Helen L. Swan.....	\$	4,788.00	
Charles Raphael .....		500.00	
Harry Camp .....		7,500.00	
Orrick, Palmer & Dahlquist (one-half of joint indebtedness of Sherwood Swan and W. R. Whitthorne totaling \$2,000).....		1,000.00	
T. E. Louis.....		725.10	
R. L. Underhill.....		200.00	
George D. Roberts.....		500.00	
McKinstry, Haber & Pierce Coombs.....		300.00	
Moose Club .....		58.50	15,571.60

## Accrued taxes—

Federal income taxes on 1936 income except that on sale of Sherwood Swan & Com- pany, Ltd. stock and alleged gain on dis- charge of bank indebtedness.....	\$	620.78	
California state income taxes on 1936 in- come accrued to December 16, 1936 (based upon same inclusions as federal tax).....		143.57	764.35

Sherwood Swan—Net Insolvency..... 10,500.83\*

\$120,835.12

\*Denotes red figure.

[Endorsed]: U. S. Board of Tax Appeals. Ad-  
mitted in evidence October 21, 1940. Petitioner's  
Exhibit 10. [244]

PETITIONERS' EXHIBIT 13

In the District Court of the United States, for  
the Northern District of California, Southern  
Division

No. 3591 S

In the Matter of the Receivership of the

CENTRAL NATIONAL BANK

OF OAKLAND,

a national banking association.

PETITION FOR AUTHORITY  
TO COMPROMISE INDEBTEDNESS

The petition of Joseph H. Grut, Receiver of the  
Central National Bank of Oakland, a national bank-  
ing association, respectfully represents unto the  
court as follows:

I.

That Central National Bank of Oakland is a  
national banking association organized under the  
laws of the United States and is hereinafter re-  
ferred to as the national bank. That prior to March  
14, 1933, said national bank was engaged in busi-  
ness as such national banking association in Oak-  
land, California. That on May 8, 1933, petitioner  
was duly appointed Receiver of said national bank  
by the Comptroller of the Currency of the United  
States, and ever since has been and now is the duly  
appointed, qualified and acting Receiver of said  
Central National Bank of Oakland, a national bank-  
ing association.

## II.

That petitioner, as such Receiver, has taken possession of and is now in possession of the assets of said national bank, and [245] particularly the following promissory notes:

(a) Promissory note dated June 28, 1931, in the sum of \$100,000.00, payable on demand to Central National Bank of Oakland, bearing interest at six per cent per annum, executed by W. R. Whitthorne and Sherwood Swan, upon which there is now due the sum of \$13,080.32, together with accrued interest from February 2, 1933.

(b) Promissory note dated January 24, 1933, in the sum of \$15,000.00, payable on demand to Central National Bank of Oakland, bearing interest at six per cent per annum, executed by W. R. Whitthorne and S. B. Swan, upon which there is now due the sum of \$15,000.00, together with accrued interest from April 14, 1933.

(c) Promissory note dated Jan. 24, 1933, in the sum of \$85,000.00, payable on demand to Central National Bank of Oakland, bearing interest at six per cent per annum, executed by W. R. Whitthorne and S. B. Swan, upon which there is now due the sum of \$85,000.00, together with accrued interest from April 18, 1933.

(d) Promissory note dated April 30, 1933, in the sum of \$66,000.00, payable on demand to

Central Bank of Oakland, bearing interest at six per cent per annum, executed by W. R. Whitthorne and Sherwood Swan, upon which there is now due the sum of \$1.00, together with accrued interest.

(e) Promissory note dated July 11, 1935, in the sum of \$25,664.67, payable on demand to Central Company, bearing interest at six per cent per annum, executed by Sherwood Swan, upon which there is now due the sum of \$25,664.67, together with interest from July 11, 1935.

(f) Promissory note dated July 11, 1935, in the sum of \$73,369.05, payable on demand to Central Company, bearing interest at six per cent per annum, executed by W. R. Whitthorne and Sherwood Swan, upon which there is now due the sum of \$73,369.05, together with interest from July 11, 1935.

That there is now due, owing and unpaid upon said promissory notes the aggregate principal sum of \$212,115.04, together with accrued interest.

That said indebtedness is secured by the following: [246]

500 shares of the capital stock of Sherwood Swan and Company, Ltd.

2000 shares of the capital stock of Swan's, a corporation

1725 shares of the capital stock of Wasserman-Gattman, a corporation



Life insurance policy of Western States Life Insurance Company, No. 240295, in the sum of \$50,000.00, insuring the life of Sherwood Bertram Swan.

That petitioner is informed and believes and therefore alleges that all of said security except said 500 shares of the capital stock of Sherwood Swan and Company, Ltd., is valueless.

### III.

That said Sherwood Swan has offered to compromise and settle said indebtedness, as aforesaid, by paying to your petitioner, as Receiver, the sum of \$75,000.00 cash and by giving to your petitioner a promissory note in the sum of \$20,000.00, payable in five years in annual instalments of \$4,000.00, bearing no interest, said note to be executed by Sherwood Swan and W. R. Whitthorne.

### IV.

That your petitioner is informed and believes and therefore alleges that said Sherwood Swan and W. R. Whitthorne are insolvent and unable to pay their obligations in full, and that said offer of compromise and settlement is the largest and best offer obtainable, and that it is for the best interests of your petitioner's trust that said offer of compromise and settlement be accepted.

## V.

That the Shareholders' Committee of the Central National Bank of Oakland, and the Central Company, have given petitioner their [247] written consent and recommendation of said compromise; and that the Comptroller of the Currency of the United States has authorized said compromise, a copy of which authorization is hereto attached, marked "Exhibit A" and by reference made a part hereof.

Wherefore, petitioner prays that this court make its order or orders authorizing petitioner to settle and compromise the obligations set forth herein upon receiving as consideration therefor the sum of \$75,000.00 cash and a promissory note in the sum of \$20,000.00, payable in five years in annual installments of \$4,000.00, bearing no interest, and executed by Sherwood Swan and W. R. Whitthorne, and that upon receiving said consideration petitioner be authorized to deliver to the owners thereof, or their nominee, the notes and collateral security securing the same, and to execute and deliver such other documents as may be necessary to effectuate said compromise.

JOSEPH H. GRUT

Receiver of Central National Bank of Oakland,  
a national banking association, in  
liquidation

FRANK S. RICHARDS

Attorney for Receiver

Verification by Joseph H. Grut December 14,  
1936. [248]

# CERTIFICATE OF SETTLEMENT

Hon. Comptroller of the Currency  
 Div. Insolvent National Banks  
 Washington, D. C.

December 16, 1936.

Sir:

Under an agreement of settlement made with J. H. Grut, Receiver of the Central National Bank of Oakland, we hereby certify that we have delivered to said Receivers:

- |   |             |
|---|-------------|
| (a) Cash in the amount of.....                            | \$75,000.00 |
| (b) Our promissory note dated December 16, 1936 for ..... | 20,000.00   |

Payable to the order of Central National Bank; in installments of Four Thousand Dollars (\$4,000.00) or more on the 15th day of December of each year, beginning on the 15th day of December, 1937, and continuing until said sum has been paid in full, without interest.

\$95,000.00

in full compromise settlement of the promissory notes held by J. H. Grut, as Receiver of the Central National Bank of Oakland, described as follows:

- |  |             |
|--|-------------|
| Asset #1224, note signed by W. R. Whitthorne and Sherwood Swan; unpaid principal balance ..... | \$13,080.32 |
| Asset #1225, note signed by W. R. Whitthorne and S. B. Swan; unpaid principal balance.....     | 15,000.00   |
| Asset #1226, note signed by W. R. Whitthorne and S. B. Swan; unpaid principal balance.....     | 85,000.00   |
| Asset #1227, note signed by W. R. Whitthorne and Sherwood Swan; unpaid principal balance ..... | 1.00        |

Asset #4933, note signed by W. R. Whitthorne  
and Sherwood Swan; unpaid principal bal-  
ance ..... 73,369.05

Asset #4898, note signed by Sherwood Swan;  
unpaid principal balance..... 25,664.67

Respectfully

SHERWOOD SWAN

W. R. WHITTHORNE

Witness:

T. H. THARP (?)

Receivers' letter of recommendation—December 2,  
1936

Office letter of approval—December 7, 1936

Court Order—December 15, 1936

(Receiver's Copy) (Copy mailed compt. 12-17-36)

[249]

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PETITIONERS' EXHIBIT 14

In the District Court of the United States, for  
the Northern District of California, Southern  
Division

No. 3591 S

In the Matter of the Receivership of the

CENTRAL NATIONAL BANK

OF OAKLAND,

a national banking association.

ORDER AUTHORIZING COMPROMISE

OF INDEBTEDNESS

The verified petition of Joseph H. Grut, Receiver  
of Central National Bank of Oakland, a national

banking association, in liquidation, heretofore filed herein, coming on regularly for hearing this 15th day of December, 1936, before the above entitled court, said Receiver being represented in court by A. W. Carlson, Esq., appearing for Frank S. Richards, Esq., his attorney, and no one appearing in opposition thereto, and it appearing to the court and the court finds that all of the allegations of said petition are true and that it is for the best interests of said Receiver's trust that said petition be granted; and it further appearing to the court and the court finds that said petitioner has been duly authorized in writing by the Comptroller of the Currency of the United States to settle and compromise the indebtedness as in said petition and hereinafter set forth; and good cause appearing therefor,

It is hereby ordered, adjudged and decreed as follows: [250]

That said petitioner, Joseph H. Grut, as Receiver of Central National Bank of Oakland, a national banking association, in liquidation, be, and he is hereby authorized to compromise and settle the indebtedness of Sherwood Swan and W. R. Whitthorne, as set forth in said verified petition, upon receiving as consideration therefor the sum of \$75,000.00 cash and a promissory note in the sum of \$20,000.00, payable in five years in annual installments of \$4,000.00, bearing no interest, and executed by Sherwood Swan and W. R. Whitthorne. That petitioner be, and he is further authorized upon receipt of said consideration to deliver to the



owners thereof, or their nominee, the notes and collateral security securing the same, and to execute and deliver such documents as may be necessary to effectuate the authority herein contained.

Done in open court this 15th day of December, 1936.

A. F. ST. SURE

Judge of the United States  
District Court

(Seal of the U. S. District Court)

[Endorsed]: Filed Dec. 15, 1936. Walter B. Maling, Clerk. By J. P. Welsh, Deputy Clerk.

[251]

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PETITIONERS' EXHIBIT 15

CERTIFICATE

I, Matt Wahrhaftig, do hereby certify as follows:

On December 16, 1936, I was duly authorized by Bank of America N. T. & S. A. to hold a Pledge Sale of the securities hereinafter described under two Pledge Agreements, one dated March 1, 1933, executed by Sherwood Swan and W. R. Whitthorne, and the other dated April 26, 1934, executed by Sherwood Swan, which said Pledge Agreements and the securities hereinafter referred to were given to secure the following promissory notes:

Note dated March 1, 1934, in the principal amount of \$99,066.33, executed by Sherwood Swan and W. R. Whitthorne to Bank of America N. T. & S. A.;

Note dated April 1, 1934, executed by Sherwood Swan to said Bank, in the principal amount of \$67,909.07;

Note dated April 1, 1934, executed by Sherwood Swan to said Bank, in the principal amount of \$15,863.62;

Note dated July 18, 1934, executed by Sherwood Swan to said Bank in the principal amount of \$560.01;

On which said four notes there was a balance due at the time of the Sale hereinafter referred to of \$196,073.14 (being the amount due after the application of \$931.95 dividend from Hale Bros. Realty Co.).

On the said 16th day of December at the hour of 11:45 A. M. thereof and at the office of J. H. Grut, Receiver of Central National Bank, Central Bank Building, Fourteenth Street and Broadway, Oakland, California, and in the presence of the following persons, to-wit:

Sherwood Swan  
W. R. Whitthorne  
P. D. Richardson  
J. H. Grut  
Lawrence Tharp  
Wallace W. Knox

I offered for sale the securities held in pledge by Bank of America N. T. & S. A. in the following manner:

I referred to the said four promissory notes, which were present at said Sale and in my possession. I referred to the said two Pledge Agreements, which were [252] present at the Sale and in my possession. I then described in detail the securities hereinafter described, which were then present at said Sale and in my possession. I then asked whether Sherwood Swan or W. R. Whitthorne had any objections to the making of the Sale or to the time and place of the sale, or whether they wished more notice thereof, or whether they wished demand of performance, or whether they wished the Sale continued to any other place, and said Sherwood Swan and W. R. Whitthorne each stated that he was satisfied with having the Sale held at that time, waived any and all notice thereof, and requested that I proceed with the Sale, specifically waiving, and each of them did waive, any and all rights to receive any additional notice given them by the Statutes of the State of California.

I thereupon asked whether anyone present desired any parcel of stock offered for sale separately.

Sherwood Swan thereupon requested the *the* five hundred shares of capital stock of Sherwood Swan and Company, Ltd., a California corporation, evidenced by the following certificates:

Certificate No. 35 for 497 shares;

Certificate No. 29 for 1 share;

Certificate No. 30 for 1 share;

Certificate No. 31 for 1 share;

be offered for sale, and I thereupon offered the said certificates for sale and said Sherwood Swan bid the sum of \$100,000.00 therefor and, there being no other and further bidders, I accepted the said sum of \$100,000.00 from said Sherwood Swan on behalf of said Bank and declared that he was the successful bidder at the Sale and caused the said certificates to be transferred to him.

I thereupon asked whether any person present desired that the remaining securities be offered for sale separately. No one requested that said securities be sold separately. I asked said Sherwood Swan and W. R. Whitthorne severally whether they or either of them desired the remaining securities sold separately and they stated that they did not.

I thereupon offered the remaining securities, consisting of two thousand seventy-one shares of capital stock of Hale Bros. Realty Co., two thousand shares of capital stock of Swan's, and seventeen hundred twenty-five shares of capital stock of Wasserman-Gattmann Co., for sale, and Bank of America N. T. & S. A. bid for said cer- [253] tificates the amount of \$96,073.14 and, there being no other bidders and the said Bank being the highest and best bidder, I declared the said securities sold to said Bank of America N. T. & S. A.

I thereupon declared that the said amount so bid by said Bank constituted full payment of the four notes above referred to, and that W. R. Whitthorne and Sherwood Swan were entitled to the

delivery to them of said promissory notes, marked "Paid".

I witness whereof, I have executed this certificate this 16th day of December, 1936.

(signed) MATT WAHRHAFTIG [254]

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PETITIONERS' EXHIBIT 17

December 31, 1930

Mr. David Wasserman  
Sacramento, California

Dear Sir:

The undersigned, makers of a promissory note in the principal sum of \$100,000.00 now payable to and held by you, advise you that we are utterly unable to pay this note or any interest thereon or any part of the principal out of any funds or assets now belonging to us.

You are now settling our liability under this note and forgiving us of our indebtedness thereunder on the receipt of Five Thousand Dollars (\$5,000.00) in cash and the promissory note of Sherwood Swan for an additional sum of Five Thousand Dollars (\$5,000.00).

You are advised that the \$5,000.00 which you are receiving in cash has been secured by us from others and is not out of our own assets.

Yours truly,

W. R. WHITTHORNE

SHERWOOD SWAN [275]



\$5,000.00

Oakland, California,  
December 31, 1930

For Value Received I promise to pay to David Wasserman or order at Sacramento, California, the sum of Five Thousand Dollars in lawful money of the United States as follows:

Three Hundred and Fifty (\$350.00) Dollars on the 1st day of February, 1932; and Three Hundred and Fifty (\$350.00) Dollars on the first day of each and every month thereafter until the entire principal sum of \$5,000.00 has been fully paid.

I further agree to pay interest at the rate of six per cent (6%) per annum, payable monthly, on all unpaid portions of the principal sum of this note.

In case any installment of principal or of interest is not paid within thirty (30) days after the same becomes due, then at the option of the payee of this note, the entire unpaid balance hereof, both principal and interest shall become immediately due and payable.

In case suit is brought to collect this note or any part thereof I agree to pay a reasonable sum for attorney's fees in such suit.

SHERWOOD SWAN

WALLACE W. KNOX

Witness to Signature [276]





[illegible]

**RECEIVED HEREON ACCEPTS THIS DRAFT IN FULL PAYMENT OF DEBT**

Pay

DOLLARS

ALL CITIZENSHIP OF JERMS STATED. FURTHER RECEIPT NOT WANTED

N. P. 15-51

SIAM A MITO

TO THE  
ORDER  
OF

**Sherwood Swan and Company, Ltd.**

90-22  
TO THE

90-22  
TO THE  
ANGLO CALIFORNIA NATIONAL BANK OAKLAND BRANCH  
4716

35-22

4216

PRESTON

COMPTON LTD.

PAY TO THE ORDER OF  
FEDERAL RESERVE BANK  
of San Francisco, Cal.

Bank or Banker  
Clearing House  
INDEMNITIES GUARANTEED

JUN 10 1937

JUN 10 1937

11-37

CF SAN FRANCISCO, CALIFORNIA

ERNAL PEVENIENT COLLECTIONS  
IN V. LEVVIS. Coll. Int. Rev.  
JOHN V. LEWIS

San Francisco, California

U.S. BOARD OF TAX APPEALS  
DIV. 10 DOCKET  
ADMITTED IN CIRCULAR  
OCT 21 1940  
EXHIBIT PETITIONERS  
RESPONDENTS  
20

55-21





# PETITIONERS' EXHIBIT 21

Sherwood Swan and W. R. Whitthorne

CALCULATION OF PRESENT VALUE OF NON-INTEREST BEARING NOTE TO CENTRAL NATIONAL BANK DATED DECEMBER 16, 1936.

Rate of discount adopted—6% per annum.

Present value of annuity of \$2,000 per annum for four years, payable at end of each year, at 6% interest compounded annually

2000 x 3.46511\* = Value at December 16, 1937.....\$6,930.22

Payment due December 16, 1937..... 2,000.00

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\$8,930.22

Discounted at 6% simple interest for period May 18, 1937 to

December 16, 1937—213 days (.06(213/365)) (8930.22)..... 311.74

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\$8,618.48

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\*Present value of payment due December 16, 1938 ( 1/1.06) .94340

39 ( .9434/1.06) .89000

40 ( .89/1.06) .83961

41 (.83961/1.06) .79210

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3,46511

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[303]

## PETITIONERS' EXHIBIT 22

Sherwood Swan and Estate of W. R. Whitthorne  
 ALLOCATION OF COST BASIS OF SHERWOOD SWAN &  
 COMPANY, LTD. OLD STOCK ENTIRELY TO NEW  
 CLASS A SHARES DECEMBER 21, 1936.

	Shares	Cost
Total Cost:		
Class A shares.....	30,000	\$100,000.00
Common shares .....	45,000	None
		<hr/>
		\$100,000.00
		<hr/>
Swan and Whitthorne (each):		
Class A shares.....	15,000	\$ 50,000.00
Common .....	22,500	None
		<hr/>
		\$ 50,000.00
		<hr/>
Allocation to Class A shares sold:		
Total shares owned each by Swan and Whitthorne .....	15,000	
	<hr/>	
Total cost .....	\$50,000.00	
	<hr/>	
Cost per share.....	\$3.333	
	<hr/>	
Sold 1936 (6250 x \$3.334).....	\$20,833.33	
	<hr/>	
Sold 1937 (6250 x \$3.334).....	\$20,833.33	
	<hr/>	

In the United States Circuit Court of Appeals  
for the Ninth Judicial Circuit

B.T.A.

Docket No. 101189

MINNIE L. WHITTHORNE and EVA WHIT-  
THORNE, Executrices, ESTATE OF W. R.  
WHITTHORNE, deceased,  
Petitioners on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent on Review.

B.T.A.

Docket No. 101190

SHERWOOD SWAN,  
Petitioner on Review,

vs.

COMMISSIONER OF INTERNAL REVENUE,  
Respondent on Review.

### STIPULATION

It is hereby stipulated by and between the parties  
above named that in the preparation of the record  
for review of the above entitled appeals before the  
United States Board of Tax Appeals, the following  
portion of the reporter's transcript may be omitted:

Page 68, l. 1 to page 72, l. 21, inclusive  
Page 74, l. 7 to page 75, l. 11, inclusive  
Page 136, l. 21 to page 139, l. 12, inclusive  
Exhibit No. 11  
Exhibit No. 12

Dated: February 5th, 1942.

R. W. MACDONALD

Attorney for Petitioners on Review

J. P. WENCHEL

Attorney for Commissioner of Internal  
Revenue, Respondent on Review [330]

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[Title of Circuit Court of Appeals and Cause.]

### ORDER

On reading and filing the Stipulation of the parties to the above entitled causes and good cause appearing therefor,

It is hereby ordered that a single record in the matter of the above entitled proceedings may be prepared for use on appeal before the United States Circuit Court of Appeals for the Ninth Judicial Circuit and that said appeals may be consolidated for hearing before said Circuit Court of Appeals.

Dated: February 27, 1942.

FRANCIS A. GARRECHT

Judge of the United States Circuit Court of  
Appeals for the Ninth Judicial Circuit

True Copy. Attest Feb. 27, 1942. Paul P.  
O'Brien, Clerk. By Frank H. Schmid, Deputy.

[Endorsed]: Filed Feb. 27, 1942. Paul P. O'Brien,  
Clerk. [331]

[Title of Board and Cause—Docket Nos. 101189,  
101190.]

CERTIFICATE

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 334, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 9th day of March, 1942.

(Seal)

B. D. GAMBLE,

Clerk,

United States Board of Tax Appeals

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[Endorsed]: No. 10087. United States Circuit Court of Appeals for the Ninth Circuit. Minnie L. Whitthorne and Eva Whitthorne, Executrices of the Estate of W. R. Whitthorne, deceased, Petitioners, vs. Commissioner of Internal Revenue, Respondent, and Sherwood Swan, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petitions to Review



Decisions of the United States Board of Tax Appeals.

Filed March 16, 1942.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

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[Title of Circuit Court of Appeals and Cause.]

### STIPULATION

It is hereby stipulated by and between the parties above named that a single record in the matter of the above entitled proceedings may be prepared for use on appeal before the United States Circuit Court of Appeals for the Ninth Judicial Circuit and that said appeals may be consolidated for hearing before said Circuit Court of Appeals.

Dated: February 5th, 1942.

R. W. MACDONALD

Attorney for Petitioners on Review

J. P. WENCHEL

Attorney for Commissioner of Internal Revenue, Respondent on Review

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[Title of Circuit Court of Appeals and Cause.]

### ORDER

On reading and filing the Stipulation of the parties to the above entitled causes and good cause appearing therefor,

It is hereby ordered that a single record in the matter of the above entitled proceedings may be prepared for use on appeal before the United States Circuit Court of Appeals for the Ninth Judicial Circuit and that said appeals may be consolidated for hearing before said Circuit Court of Appeals.

Dated: February 27th, 1942.

FRANCIS A. GARRECHT

Judge of the United States Circuit Court of  
Appeals for the Ninth Judicial Circuit

[Endorsed]: Filed Feb. 27, 1942.

[Endorsed]: Refiled Mar. 16, 1942.

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[Title of Circuit Court of Appeals and Cause.]

STATEMENT OF POINTS ON WHICH  
APPELLANT INTENDS TO RELY ON  
APPEAL

I.

Taxpayers did not realize taxable income by reason of cancellation by banks of their indebtedness during the taxable year.

1. Stock in Sherwood Swan and Company, Ltd. which was released by banks in taxable year 1936 had in 1930 been freed from pursuit from all bank indebtedness except \$200,000.

2. In determining taxpayers' solvency or insolvency after the cancellation of indebtedness, assets freed from the burden of debt by

the cancellation cannot be valued at any amount in excess of their cost basis to taxpayers.

3. Using cost as the proper valuation of the assets freed, taxpayers did not receive any taxable income incident to the release of such assets and the cancellation of indebtedness.

4. Any income to taxpayers incident to the release of assets occasioned by the cancellation of indebtedness, cannot exceed the net fair market value in the taxable year of the assets so released.

5. Using the fair market value basis, taxpayers did not realize taxable income by reason of cancellation of indebtedness.

## II.

The fair market value of the common stock of Sherwood Swan and Company, Ltd. in the taxable year cannot be determined; accordingly, the entire cost to taxpayers of the Sherwood Swan and Company, Ltd. stock should be applied as the basis for the Class A preferred stock sold by them.

## III.

There was reasonable cause for the one day delay of taxpayers in the filing of their return and taxpayers should be relieved from the penalty imposed.

R. W. MACDONALD

Attorney for Petitioners—Appellants.